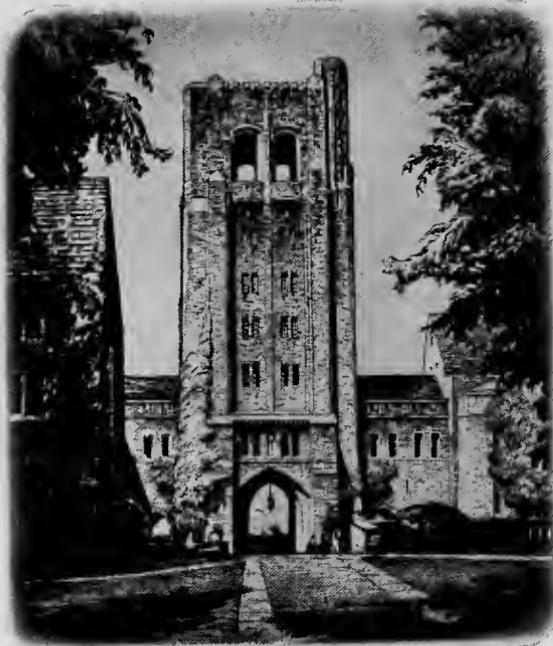


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# Commercial Banking Practice

under the

Federal Reserve Act



**National Bank of Commerce  
in New York**

Revised to October, 1921

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# Commercial Banking Practice

under the  
Federal Reserve Act

*The Law and the Regulations,  
Rulings and Opinions of Counsel  
of the Federal Reserve Board  
Governing Bank Acceptances,  
Rediscounts, Advances and  
Open Market Transactions of  
the Federal Reserve Banks*



THIRD EDITION  
REVISED TO OCTOBER, 1921.

National Bank of Commerce  
in New York

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*National Bank of Commerce  
in New York*



## Foreword

IN *Commercial Banking Practice* it has been the purpose of the National Bank of Commerce in New York to present a reference manual in convenient form for the use of business men and bankers. This edition is the third to be issued since 1917, and has been revised to include new and modified rulings of the Federal Reserve Board.

JAMES S. ALEXANDER  
*President*



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## **AUTHORITIES**

This book has been compiled from the following  
official sources:

**FEDERAL RESERVE ACT**

**NATIONAL BANK ACT**

**WAR FINANCE CORPORATION ACT**

**REGULATIONS OF THE FEDERAL RESERVE BOARD**

**FEDERAL RESERVE BULLETIN**

*First Edition, July, 1917  
Second Edition, October, 1918  
Third Edition, October, 1921*

## PART I.

### Bank Acceptances

The term "acceptance" designates a draft or bill of exchange drawn to order, payable at a definite time after date or sight, the obligation to pay which has been accepted by an acknowledgment thereon written or stamped and signed (generally across the face of the instrument) by the party on whom the bill is drawn. This acknowledgment, which generally consists merely of the word "accepted" followed by signature and date, constitutes the agreement of the acceptor to pay the draft at maturity according to its tenor, without qualifying conditions. To be negotiable, such an accepted bill must be for a definite amount and must be payable in money.

An ordinary "trade acceptance" is created when, for example, the seller of merchandise draws a draft for the purchase price on the purchaser and the purchaser accepts the draft. The purchaser, however, may enter into an agreement with his bank whereby the bill is drawn on the bank and is accepted by it for his account instead of by the purchaser himself. Such a draft, when accepted, becomes a "bank acceptance." The Federal Reserve Board has defined a bank acceptance as "a draft or bill of exchange . . . of which the acceptor is a bank or trust company, or a firm, person, company, or corporation engaged generally in the business of granting bankers' acceptance credits."

Bank acceptance

Definition

**Use of  
bank  
acceptances**

Bank acceptances are used largely in financing international trade and domestic transactions involving major staple commodities. They hold a preeminent place among credit instruments and offer a means of investment in which the credit risk has practically been eliminated. This is due to the fact that direct responsibility for their payment rests on banking institutions whose credit is generally and widely known.

**Coverage of  
acceptances**

At a meeting of the leading banks and bankers of New York, Boston, Philadelphia, and other cities, held at the National Bank of Commerce in New York, August 14, 1918, it was resolved that:

“The accepting bank shall require from its clients that it be placed in funds to meet acceptances on day of maturity either by

- “(a) The deposit of clearing house funds one day prior to maturity, or
- “(b) The deposit of cash or check on the Federal Reserve Bank of New York on the day of maturity, or
- “(c) Debit to the account of the bank’s client on day of maturity against funds cleared on, or prior to, such date.”

**Acceptance of  
eligible bills**

Since accepting banks do not ordinarily accept bills other than those which are eligible for rediscount or purchase at Federal reserve banks, those subdivisions of Parts II and IV which relate to the rediscount and purchase of bank acceptances (pages 134-148 and 153-163, below) should be read in connection with Part I.

## General Statutory Provisions

Any member bank may accept drafts or bills of exchange drawn upon it having not more than six months' sight to run, exclusive of days of grace, which grow out of transactions involving the importation or exportation of goods; or which grow out of transactions involving the domestic shipment of goods provided shipping documents conveying or securing title are attached at the time of acceptance; or which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples. No member bank shall accept, whether in a foreign or domestic transaction, for any one person, company, firm, or corporation to an amount equal at any time in the aggregate to more than ten per centum of its paid-up and unimpaired capital stock and surplus, unless the bank is secured either by attached documents or by some other actual security growing out of the same transaction as the acceptance; and no bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half of its paid-up and unimpaired capital stock and surplus: *Provided, however, That* the Federal Reserve Board, under such general regulations as it may prescribe, which shall apply to all banks alike regardless of the amount of capital stock and surplus, may authorize any member bank to accept such bills to an amount not exceeding at any time in the aggregate one hundred per centum of its paid-up and unimpaired capital stock and surplus: *Provided, further, That* the aggregate of acceptances growing out of domestic transac-

Acceptance  
of drafts

Against imports  
and exports  
Against domestic  
shipments

Against warehoused  
staples

Limit on  
acceptances  
for one  
interest

Limit on aggregate  
acceptances

Extension of  
limit

Limit on aggregate  
domestic acceptances

tions shall in no event exceed fifty per centum of such capital stock and surplus.

Acceptances for dollar exchange

Any member bank may accept drafts or bills of exchange drawn upon it having not more than three months' sight to run, exclusive of days of grace, drawn under regulations to be prescribed by the Federal Reserve Board by banks or bankers in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange as required by the usages of trade in the respective countries, dependencies, or insular possessions. . . . *Provided, however,* That no member bank shall accept such drafts or bills of exchange referred to in this paragraph for any one bank to an amount exceeding in the aggregate ten per centum of the paid-up and unimpaired capital and surplus of the accepting bank unless the draft or bill of exchange is accompanied by documents conveying or securing title or by some other adequate security: *Provided, further,* That no member bank shall accept such drafts or bills in an amount exceeding at any time the aggregate of one-half of its paid-up and unimpaired capital and surplus.

Acceptances for one bank limited

Limit on aggregate of such acceptances

(Federal Reserve Act, Section 12.)

## Bank Acceptances Based on Imports and Exports

### CHARACTER Statutory Provisions

Any member bank may accept drafts or bills of exchange drawn upon it . . . which grow out of transactions involving the importation or exportation of goods.

(Federal Reserve Act, Section 18.)

Acceptances  
in foreign  
trade

### Opinions and Rulings

#### Determination of Character of Transactions on Which Acceptances Are Based.

Held not to be necessary that the specific goods covered by an acceptance based upon an import or export transaction must be identified at the time of the acceptance.

Identification  
of specific  
goods not  
required

(Ruling, Federal Reserve Bulletin, December, 1915, page 405. See also Regulation A, Series of 1920, B, pages 135-137, below.)

Good faith must be relied upon to a large extent in determining whether an acceptance is based upon a transaction involving the importation or exportation of goods. A member bank would be justified in putting on the legend "this acceptance is based on a transaction involving the importation or exportation of goods," provided it is satisfied the statement by its customer is made in good faith.

Good faith  
a test

(Ruling, Federal Reserve Bulletin, December, 1915, page 406.)

The Federal reserve bank reserves the right to ask State member banks for evidence underlying the certification given to it, and the bank examiner may

Substantiation  
of customers'  
assurances

No 42/227

3422

Colombo, Ceylon, 10<sup>th</sup> May 1921.

To Government

The Treasury

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require evidence from the national bank. Member banks would, therefore, best protect themselves by stipulating for themselves the right at times to ask for substantiation of the assurances given by their customers.

(Ruling, Federal Reserve Bulletin, December, 1915, page 406.)

**Transaction Must Itself Involve Import or Export of Goods.**

A transaction, in order to be the basis of a draft or bill eligible for acceptance by a member bank, must itself involve the importation or exportation of goods. A transaction wholly independent of the transaction covering the importation or exportation of goods is not sufficient basis for an acceptance, under the terms of section 13 (relating to acceptances against imports or exports).

Transactions independent of import or export not sufficient basis

(Opinion of Counsel, Federal Reserve Bulletin, September, 1915, page 276.)

Where the contract between a seller of goods who draws a draft and the purchaser is entirely independent of the contract for the export of the goods, the draft would have to be treated as drawn in a domestic transaction and would have to be accompanied by shipping documents or secured by warehouse receipts or other similar documents conveying and securing title when accepted by the drawee bank.

Drafts treated as drawn in domestic transactions

(Ruling, Federal Reserve Bulletin, May, 1918, page 435.)

A draft drawn by an importer of goods for the purpose of procuring funds with which to pay the foreign seller of those goods is eligible for acceptance by a member bank whether or not the bill of lading covering the goods is attached to the draft and whether or not the goods have actually been

Importers' purchases money drafts

shipped by the seller at the time the draft is drawn. In such a case, that is, where there has been an actual sale of goods for export, the draft which is to procure funds with which to pay for those goods is one which clearly grows out of a transaction involving the importation of goods within the meaning of section 13, and as such is eligible for acceptance by a member bank, provided, of course, that it complies in other respects with the terms of the law and the regulations of the Federal Reserve Board.

This ruling is not intended in any way to apply to the case of a draft drawn by an American manufacturer for the purpose of financing the purchase of goods not from a foreign seller but from an American importer.

(Ruling, Federal Reserve Bulletin, February, 1920, page 162.)

Intention  
to import  
not sufficient  
basis

Drafts drawn under an agreement whereby the drawer agrees to manufacture and import into the United States in time to meet the maturity of such drafts certain products which shall have been sold by the shipper and are to be ready for immediate delivery and consigned to a firm of bankers procuring the acceptance of such drafts for the drawer are not eligible for acceptance by member banks; since they do not grow out of "transactions involving the importation or exportation of goods" within the meaning of section 13 of the Federal Reserve Act. In the absence of shipping documents and warehouse receipts securing such drafts they could not be accepted as drawn in a domestic transaction.

(Opinion of Counsel, Federal Reserve Bulletin, October, 1918, page 976. See also Regulation A, Series of 1920, B, pages 185-187, below.)

If a drawee bank accepts at the instance of the purchaser of goods, the purchaser having a contract to export such goods, the drafts would grow out of a transaction involving the export of goods and could be accepted by the drawee bank under authority of section 13.

(Ruling, Federal Reserve Bulletin, May, 1918, page 435.)

Where a domestic corporation "A" enters into a contract with another domestic corporation "B" to furnish material to be used by "B" in the manufacture of products which "B" is under contract to export, the mere fact that the material furnished is ultimately intended for export in some form cannot be said to merge the two transactions into one. The transaction between "A" and "B" could not be said to involve the exportation of goods.

(Opinion of Counsel, Federal Reserve Bulletin, September, 1915, page 276.)

The mere fact that the drawer is manufacturing goods which he intends ultimately to export does not alone bring it within the scope of a transaction involving the exportation of goods. The person for whom the draft is accepted must have a definite bona fide contract for the shipment of the goods within a specified and reasonable time.

(Opinion of Counsel, Federal Reserve Bulletin, January, 1920, page 66.)

National banks cannot accept drafts for the purpose of enabling domestic concerns to extend credits on open account to foreign purchasers.

(Ruling, Federal Reserve Bulletin, March, 1919, page 258.)

An acceptance house which has purchased an acceptance based on the importation or exportation of goods desires to reimburse itself by drawing a bill upon a national bank, pledging as collateral

Acceptance  
at instance  
of exporter

Intention  
to export  
ultimately  
not sufficient  
basis

Contract to  
export

Acceptances  
against  
open accounts

Drafts drawn  
against  
collateral of  
acceptance

security for the bill the original acceptance. It is held that the new bill cannot properly be said to grow out of the original export transaction in the sense contemplated by the Federal Reserve Act.

**Ineligible  
for acceptance**

A national bank is not authorized to accept a draft drawn under the above circumstances because it is not an acceptance growing out of a transaction involving the importation or exportation of goods, nor drawn by a bank or banker located in a foreign country, nor does it grow out of a transaction involving the domestic shipment or storage of goods.

(Ruling, Federal Reserve Bulletin, January, 1917, page 29.)

**Acceptance  
secured by  
documentary  
drafts**

A draft drawn upon a national bank which is secured by a documentary draft drawn by the same drawer upon a foreign buyer is eligible for acceptance by the national bank. However, no bank which has purchased a foreign documentary draft may refinance itself by drawing a draft on a member bank secured by the documentary draft. If, however, the seller or shipper of goods draws a draft upon the foreign buyer or consignee payable abroad and secured by shipping documents, it is proper for the drawer to finance that shipment by a banker's acceptance secured by that documentary draft.

(Ruling, Federal Reserve Bulletin, June, 1920, page 610.)

**Acceptance of Drafts Prior to Purchase or Sale of Goods Imported or Exported.**

**Goods purchased  
subsequent to  
acceptance**

In interpreting the word "involved" in connection with the importation or exportation of goods, upon which an acceptance has been based, it is held that goods may be purchased and shipped subsequent to the time of the first acceptance, provided that there is a definite bona fide contract for the

shipment of the goods within a specified and reasonable time.

(Ruling, Federal Reserve Bulletin, December, 1915, page 405.)

Section 13 of the Federal Reserve Act is construed to justify a national bank in accepting a draft drawn upon it in settlement of advances for cotton being accumulated by cotton buyers for export. The fact that there is a temporary delay in actual shipment of goods is immaterial.

Delay in  
shipment  
immaterial

(Ruling, Federal Reserve Bulletin, September, 1916, page 458.)

A national bank may properly accept a draft, drawn for the purpose of importing goods whether or not the sale of the goods under consideration has actually been consummated at the time of the acceptance of the draft, if the accepting bank is assured that the proceeds of the draft will ultimately be used solely for the purpose of financing a transaction involving the importation of goods. It is not necessary that the goods to be sold be identified at the time of acceptance. The accepting bank, however, must be reasonably sure that the draft is drawn for the purpose of financing a transaction involving the importation or exportation of goods, and that its proceeds will be used for that purpose.

Acceptances  
against future  
importations  
of goods

(Ruling, Federal Reserve Bulletin, July, 1917, page 527.)

A member bank would be justified, if fully secured, in accepting drafts drawn by a local cotton-buying firm having a contract to sell to foreign buyers if the transaction, after having been made in good faith, ultimately resulted in the sale of the cotton to an American instead of a foreign purchaser. It was assumed in connection with this interpretation of section 13 that the bank had received

Export contract  
not fulfilled

permission from the Board to accept drafts or bills of exchange drawn upon it; that the cotton buyers had a contract to sell cotton to a firm of Liverpool; that they held the cotton subject to shipping receipt of the Liverpool firm; and that because of freight rates and shipping conditions the Liverpool firm changed its policy and directed the sale of the cotton.

(Ruling, Federal Reserve Bulletin, January, 1916, page 13.)

**Acceptance Agreements of Dealers in Same Goods for Export and Domestic Sale.**

If dealers purchasing or producing the same class of goods both for export and domestic sale wish to finance their export transactions by means of eligible bankers' acceptances, the Board suggests that the contracts between such dealers and their accepting banks contain the following provisions, (a) that the dealer has entered into contracts providing for the exportation of goods of a specified amount within a specified and reasonable time; (b) that the total amount of drafts drawn by the dealer under credits opened to finance the exportation of such goods shall at no time exceed the aggregate amount of the export transactions contracted for and in process of execution; (c) that the proceeds of drafts drawn against the accepting bank under this credit will be used to consummate the export contracts referred to, that the dealer will furnish in due course to the accepting bank shipping documents covering such goods, and that the proceeds of the sale of the goods exported will be applied in liquidation of the acceptance credit.

(Ruling, Federal Reserve Bulletin, January, 1921, page 70.)

Stipulations  
essential  
to eligibility  
at reserve  
banks

**Acceptances Against Coin and Bullion.**

Gold coin is "goods" within the meaning of section 18 of the Federal Reserve Act. Gold coin

(Ruling, Federal Reserve Bulletin, January, 1917, page 29.)

Gold bars may be properly considered as goods. Bullion

(Ruling, Federal Reserve Bulletin, January, 1917, page 29.)

**MATURITY****Statutory Provisions**

Any member bank may accept drafts or bills of exchange drawn upon it having not more than six months' sight to run, exclusive of days of grace. Maturity

(Federal Reserve Act, Section 18.)

**Opinions and Rulings**

A national bank is held to be authorized to enter into an agreement having more than six months to run, by the terms of which it obligates itself for a period of time specified in the agreement to accept drafts drawn upon it, provided such drafts grow out of transactions involving the importation or exportation of goods, and that the individual drafts have not more than six months' sight to run. This distinction is emphasized: "While a letter of credit or credit agreement may lawfully be made by a national bank which will extend by its terms for a period exceeding six months, the agreement must not be of such a character as will impose upon the holders of drafts accepted thereunder any obligation to renew such drafts so that the period of acceptance shall exceed six months in duration as to any specified draft."

Duration of  
acceptance  
credits

(Ruling, Federal Reserve Bulletin, September, 1915, page 269.)

There is no objection to a national bank's agree-

ing in advance to accept drafts aggregating certain amounts for a period of more than six months, but each individual draft drawn under a credit of that character must comply with the provisions of the law relating to the acceptance of the original draft.

(Opinion of Counsel, Federal Reserve Bulletin, January, 1920, page 67.)

**Determination  
of maturity**

Where a six months' credit is required it is improper to grant that credit by means of two three months' acceptances for the purpose of making the acceptances at all times eligible for rediscount by Federal reserve banks. On the other hand, the period covered by an acceptance should not be in excess of that which is usual and reasonably necessary to finance the underlying transaction.

(Ruling, Federal Reserve Bulletin, March, 1921, page 308.)

**Statement  
of case**

A national bank makes acceptances covering the importation of automobile parts from France, with a maturity of ninety days, which is supposed to be sufficient to cover payment for the merchandise in France, its transit to New York, its warehousing, and subsequent sale from warehouse. It is found, however, that before the transaction has been completed by the sale of the merchandise, the ninety-day period has expired, although the parts had already arrived and were stored pending resale. The question is on the propriety of making renewal acceptances to finance the storage and resale.

**Basis of  
acceptances**

Automobile parts can not be regarded as readily marketable staples within the meaning of section 13. Consequently, if the drafts are to be secured by warehouse receipts covering the automobile parts, that fact would not of itself make the drafts eligible for acceptance by national banks. The drafts are eligible for acceptance only if and upon

the ground that they can be said to grow out of the importation of the automobile parts within the intent of section 13.

The Board is of the opinion that where the goods have come into the possession of the importer in the United States, who is the taker of the credit, the transaction involving the importation of those goods must be considered so far concluded as to preclude the issuance of a renewal draft based upon that transaction. The Board is of the opinion, therefore, that upon the facts stated the renewal drafts would be ineligible for acceptance by national banks.

Renewals in concluded transactions

(Ruling, Federal Reserve Bulletin, June, 1921, page 699.)

The acceptance of a private banking house made for a bag company, stating in the body of the draft that it is for burlap from Calcutta stored on the docks, might be continued or renewed while the goods are on the docks.

Renewals against imports on docks

(Ruling, Federal Reserve Bulletin, January, 1917, page 30.)

## AMOUNT BANK MAY ACCEPT FOR ONE INTEREST

### Statutory Provisions

No member bank shall accept, whether in a foreign or domestic transaction, for any one person, company, firm, or corporation to an amount equal at any time in the aggregate to more than ten per centum of its paid-up and unimpaired capital stock and surplus, unless the bank is secured either by attached documents or by some other actual security growing out of the same transaction as the acceptance.

Ten per cent. limit

Exception

(Federal Reserve Act, Section 13.)

### Regulations of Federal Reserve Board

The fifth paragraph of section 13 of the Federal Reserve Act as amended . . . limits the amount which any bank shall accept for any one person, company, firm, or corporation, whether in a foreign or domestic transaction, to an amount not exceeding at any time, in the aggregate, more than ten per centum of its paid-up and unimpaired capital stock and surplus. This limit, however, does not apply in any case where the accepting bank remains secured either by attached documents or by some other actual security growing out of the same transaction as the acceptance. A trust receipt which permits the customer to have access to or control over the goods will not be considered by Federal reserve banks to be "actual security" within the meaning of section 13. A bill of lading draft, however, is "actual security" even after the documents have been released, provided that the draft is accepted by the drawee upon or before the surrender of the documents.

(Regulation C, Series of 1920, A, I.)

### Opinions and Rulings

Acceptances  
of foreign  
correspondent  
under  
guarantee of  
national bank

Drafts accepted by foreign correspondents at the request and under the guarantee of a national bank in the United States should be reported as a direct liability of such national bank, and treated as subject to the limitations imposed by the Federal Reserve Act on the acceptance power of national banks.

(Opinion of Counsel, Federal Reserve Bulletin, April, 1918, page 311. See also "Letters of Credit and Acceptances Issued for Correspondents," pages 59-63, below.)

The acceptance by a bank of unsecured drafts (under the guarantee of one of its customers) to an amount exceeding ten per cent. of the capital and surplus of the bank would constitute a violation of the limitation contained in section 13 of the Federal Reserve Act, whether or not the customer of the bank guaranteeing the acceptance is the drawer of the draft, or some other person.

Guarantee does not constitute actual security

(Ruling, Federal Reserve Bulletin, February, 1919, page 143.)

**Exemption from Ten Per Cent. Limit.**

The ten per cent. limit upon the amount of acceptances which any member bank might make for any one person, company, firm, or corporation does not apply if "the bank is secured either by attached documents or by some other actual security growing out of the same transaction as the acceptance."

Secured bills

If documents which were attached at the time of the acceptance are surrendered and no other security growing out of the same transaction is substituted, the ten per cent. limit will apply. The accepting bank must remain secured in the manner prescribed during the life of the acceptance in order to be exempt from the ten per cent. limit.

Accepting bank must remain secured

(Ruling, Federal Reserve Bulletin, April, 1917, page 286.)

Under the provisions of section 13 a member bank may accept for any one customer in excess of ten per cent. of its capital and surplus, provided it is secured by attached documents or by some other actual security growing out of the same transaction as to all acceptances in excess of that ten per cent. limitation.

Character of security

(Opinion of Counsel, Federal Reserve Bulletin, April, 1919, page 364.)

A syndicate of American banks has accepted drafts drawn by the A Bank under a credit to finance the importation of coffee. The A Bank is a subsidiary of the B Bank, which executed the acceptance agreement and guaranteed the entire credit. As and when shipments are actually made the shipping documents are forwarded to the B Bank, and such documents and any documents covering the coffee after arrival are held by that bank as the agent for the accepting banks.

**Custody  
of security**

While it is not necessary that the attached documents or other security be in the physical possession of the accepting bank, since possession by an agent is in law possession by the principal, the Board is of the opinion, and has heretofore ruled, that the accepting bank is not secured in compliance with this provision when documents are held by the drawer of the drafts for account of the acceptor. So, also, the Board is of the opinion that the provision is not complied with if documents are held by the acceptor's customer; that is, by a party upon whose credit the acceptor relied in accepting the drafts.

**By subsidiary**

The fact that the drawer of the drafts is a subsidiary of the B Bank does not of itself prevent the latter bank from being a proper party to hold security for the accepting banks, but the fact that the B Bank arranged and guaranteed the credit indicates that that bank is the customer or one of the customers whose credit the accepting banks relied upon in making the acceptances.

The Board is of opinion, therefore, that upon the facts stated the accepting banks are not secured within the meaning of the provision of section 13 when the documents are held by the B Bank for

account of the accepting banks, and, consequently, that no member bank should have outstanding acceptances drawn under this credit in excess of ten per cent. of its capital and surplus, unless some arrangement is made whereby the documents are to be held by some other party.

(Ruling, Federal Reserve Bulletin, April, 1921, page 418.)

The only doubtful question is as to what constitutes "some other actual security growing out of the same transaction as the acceptance." The ten per cent. limit does not apply where the acceptor holds:

1. Shipping documents;
2. Warehouse receipts;
3. Trust receipts which do not enable the borrower to obtain the goods for his own use.

The ten per cent. limit does apply where the bank holds merely the ordinary trust receipt which gives it only a lien on the goods in the hands of the purchaser or on their proceeds.

(Ruling, Federal Reserve Bulletin, April, 1917, page 286.)

If an acceptance is secured by shipping documents which are surrendered by the acceptor for a trust receipt which permits the purchaser of the goods to retain control of the goods, the accepting bank cannot be said to be secured "by some other actual security" as provided in section 13 of the Federal Reserve Act. A trust receipt, however, which does not permit the purchaser to procure control of the goods, may properly be said to be actual security within the meaning of the Act.

(Opinion of Counsel, Federal Reserve Bulletin, November, 1917, page 881.)

Where the total amount accepted for any one

What constitutes  
actual security  
growing out of  
same transaction

Trust receipts  
as actual  
security

customer exceeds ten per cent. of the capital and surplus of the accepting bank the security cannot be released unless some other actual security growing out of the same transaction is substituted therefor. A trust receipt which permits the customer for whom the draft is accepted to obtain control of the goods is not actual security for the purposes of this provision of the law.

(Ruling, Federal Reserve Bulletin, March, 1919, page 253.)

**Substitution  
of security**

A corporation ships goods consigned to its own agent; it draws a time draft on its own bank with the bills of lading attached; the bank accepts, the acceptance being in excess of ten per cent. of its capital and surplus. The question is whether the bills of lading may be released by the bank to the agent who is the consignee, provided that the agent substitutes therefor other drafts secured by bills of lading covering the same goods which were being shipped by the agent to various dealers. The Board is of the opinion that the new drafts, secured by bills of lading covering the same goods, do constitute some other actual security. This security is not only an actual security within the meaning of the Act, but it grows out of the same transaction as the original acceptance, and therefore, the substitution may properly be made.

(Ruling, Federal Reserve Bulletin, May, 1919, page 468.)

**Trade acceptance  
as actual  
security**

An exporter draws a documentary draft on a foreign purchaser and uses the export draft as security for a ninety-day draft against his bank in an amount in excess of ten per cent. of the bank's capital and surplus. The bank accepts the ninety-day draft and forwards the export draft for acceptance. The foreign buyer accepts the draft,

which thereupon becomes a trade acceptance, and receives the shipping documents.

The trade acceptance drawn on and accepted by the foreign buyer may be considered "actual security" within the meaning of section 13 of the Federal Reserve Act.

(Ruling, Federal Reserve Bulletin, October, 1920, page 1065.)

**Relation of United States Revised Statutes, Section 5200, to the Ten Per Cent. Limit.**

The limitations imposed by section 5200, Revised Statutes, on the amount of money which may be borrowed by any individual from a member bank do not apply to acceptances of such bank unless purchased by the accepting bank.

When not applicable

A member bank may legally purchase its own acceptances, but such a transaction is equivalent to a loan or advance to the customer for whom the acceptance was made and the liability of such customer becomes subject to the limitations of section 5200, Revised Statutes.

When section 5200 applies

(Opinion of Counsel, Federal Reserve Bulletin, December, 1916, page 680.)

Where a national bank has already loaned ten per cent. of its capital and surplus to a certain company, it may, while the loan is still outstanding, obligate itself as acceptor on a draft drawn by the same company.

Acceptances in addition to loans

If, however, the member bank discounts its own acceptance under the foregoing circumstances, it must treat the transaction as a loan and not as an acceptance, and could not in that case lend to, and accept for, the same firm in an aggregate amount in excess of the ten per cent. prescribed by section 5200.

(Ruling, Federal Reserve Bulletin, March, 1918, page 197.)

When drawer  
fails to provide  
funds to meet  
acceptance

The ten per cent. limitation imposed by section 5200 of the Revised Statutes is not intended to apply to the mere acceptance of a bill of exchange, but the provisions of section 5200 would apply to the indebtedness arising between the drawer of the bill and the accepting bank in case the drawer fails to furnish funds with which to meet the acceptance at maturity.

(Ruling, Federal Reserve Bulletin, September, 1915, page 269, February, 1916, page 64.)

## AGGREGATE AMOUNT BANK MAY ACCEPT Statutory Provisions

Fifty per  
cent. limit

No bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half of its paid-up and unimpaired capital stock and surplus: *Provided, however,* That the Federal Reserve Board, under such general regulations as it may prescribe, which shall apply to all banks alike regardless of the amount of capital stock and surplus, may authorize any member bank to accept such bills to an amount not exceeding at any time in the aggregate one hundred per centum of its paid-up and unimpaired capital stock and surplus.

(Federal Reserve Act, Section 18.)

Acceptances  
up to 100 per  
cent.

Application  
for power to  
accept up to  
100 per cent.

## Regulations of Federal Reserve Board

1. Under the provisions of the law referred to above the Federal Reserve Board has determined that any member bank, having an unimpaired surplus equal to at least twenty per centum of its paid-up capital, which desires to accept drafts or bills of exchange drawn . . . [against domestic or foreign shipments of goods or secured by warehouse receipts], up to an amount not exceeding at any time, in the aggregate, one hundred per centum of

its paid-up and unimpaired capital stock and surplus, may file an application for that purpose with the Federal Reserve Board. Such application must be forwarded through the Federal reserve bank of the district in which the applying bank is located.

2. The Federal reserve bank shall report to the Federal Reserve Board upon the standing of the applying bank, stating whether the business and banking conditions prevailing in its district warrant the granting of such applications.

Report on application

3. The approval of any such application may be rescinded upon ninety days' notice to the bank affected.

(Regulation C, Series of 1920, A, II.)

### Opinions and Rulings

Authority from the Federal Reserve Board is not necessary for a member bank to undertake acceptance business, unless the bank wishes to exceed fifty per cent. of its capital and surplus.

Permission to accept up to 50 per cent. not required

(Ruling, Federal Reserve Bulletin, July, 1915, page 126.)

Where a bank has been granted permission to accept in an amount not exceeding in the aggregate one hundred per cent. of its paid-up capital and surplus, it is not necessary for such bank to obtain additional authority from the Board each time it increases its surplus.

Increases of surplus

(Ruling, Federal Reserve Bulletin, February, 1919, page 143.)

Drafts accepted by foreign correspondents at the request and under the guarantee of a national bank in the United States should be reported as a direct liability of such national bank, and should be treated as subject to the limitations imposed by

Acceptances of correspondents under guarantee of national bank

the Federal Reserve Act on the acceptance power of national banks.

(Opinion of Counsel, Federal Reserve Bulletin, April, 1918, page 311. See also "Letters of Credit and Acceptances Issued for Correspondents," pages 59-68, below.)

Purchase of  
bank's own  
acceptance

When a member bank purchases its own acceptance before maturity such acceptance need not be included in the aggregate of acceptances authorized by section 13.

(Opinion of Counsel, Federal Reserve Bulletin, August, 1916, page 397. See also "Purchase by National Bank of its own Acceptances," pages 67-68, below.)

Limitations  
of section  
5202

The limitations imposed by section 5202, Revised Statutes, on the liabilities incurred by any national bank do not apply to acceptances of such banks.

(Opinion of Counsel, Federal Reserve Bulletin, December, 1916, page 680.)

Letters of  
credit  
not limited  
by section 5202

Inasmuch as a commercial letter of credit is simply an agreement to make acceptances, and the authority of national banks to issue such letters of credit is incidental to the authority expressly granted by section 13 of the Act to make acceptances in certain transactions, and such letters may properly be issued only in connection with the kinds of transactions specified in that section, it seems clear that the liability of a member bank upon a commercial letter of credit is a liability incurred under the provisions of the Federal Reserve Act, and is not subject to the limitations of section 5202 of the Revised Statutes.

Letters of  
credit not  
limited by  
section 13

The Board is further of the opinion that the liability incurred upon a commercial letter of credit—that is, upon the agreement or letter itself, as distinguished from the acceptances made thereunder—should not be classified as an acceptance liability within the limitation imposed upon the aggregate

amount of acceptances outstanding at any one time under the provisions of section 13 of the Federal Reserve Act. It would seem that a member bank may issue a letter of credit, the aggregate amount of which may be in excess of the fifty per cent. or one hundred per cent. of the bank's capital and surplus, provided that the aggregate amount of the acceptances made under the letter of credit and outstanding at any one time does not exceed, in addition to the bank's other outstanding acceptances, the aggregate limitation upon acceptances prescribed in section 13.

Nevertheless, a member bank should not obligate itself to accept drafts under a letter of credit to such an amount that it is reasonable to anticipate that the aggregate amount of acceptances issued under that letter and outstanding at any time, together with other acceptances which may be outstanding, will exceed at any one time the limitation to which the member bank is subject.

Reasonable  
limit

(Opinion of Counsel, Federal Reserve Bulletin, July, 1921, page 816.)

## **Bank Acceptances Based on Domestic Shipments of Goods**

### **CHARACTER**

#### **Statutory Provisions**

**Acceptances  
in domestic  
trade**

Any member bank may accept drafts or bills of exchange drawn upon it . . . which grow out of transactions involving the domestic shipment of goods provided shipping documents conveying or securing title are attached at the time of acceptance.

(Federal Reserve Act, Section 13.)

#### **Opinions and Rulings**

**Eligibility  
not dependent  
on security  
alone**

A draft drawn by the purchaser of the goods against a national bank is not eligible for acceptance by that bank merely because it is secured by a bill of lading covering the goods bought.

The law contemplates some actual connection between the acceptance of the draft and the transaction involving the sale and shipment of the goods—that is, it was evidently intended that the draft should be drawn to finance that transaction. If a seller ships goods and mails the bill of lading to the purchaser and on arrival of the bill of lading the purchaser draws on his own bank, attaching the bill of lading as security, and offers it for acceptance, the transaction is merely a straight loan to the drawer secured by a bill of lading. As such it would not come within the spirit of the provisions of section 13.

(Opinion of Counsel, Federal Reserve Bulletin, May, 1917, page 380.)

No. 1646

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**SPECIMEN OF BANK ACCEPTANCE BASED ON DOMESTIC SHIPMENT.**

Application  
of proceeds

A draft drawn by the purchaser of goods is not eligible for acceptance merely because it is secured at the time of acceptance by a bill of lading covering the goods bought. It must be established that the proceeds of the draft are applied to the payment of those goods.

(Opinion of Counsel, Federal Reserve Bulletin, January, 1920, page 66.)

Automobiles  
and tires

The ruling that automobiles and tires cannot properly be considered readily marketable staples should not be construed to deny the right of a member bank to accept a draft to which is attached at the time of acceptance a bill of lading covering an automobile or automobile tires in the process of shipment, provided that the draft otherwise complies with the terms of the law and the regulations of the Federal Reserve Board.

(Ruling, Federal Reserve Bulletin, January, 1920, page 65.)

Shipment  
of oil

An oil-producing company had contracted to sell oil for cash to an oil-distributing company and the latter had, in turn, contracted to sell the oil on credit to a railroad company. The distributing company wished to draw drafts upon the national bank, secured at the time of acceptance by bills of lading covering the oil in transit from the producing company to the railroad company and with the proceeds of the accepted drafts to pay the producing company for the oil.

The drafts drawn by the distributing company would be eligible for acceptance by the national bank, providing the bank is secured at the time of acceptance by shipping documents which convey or secure title to the oil, and provided, further, that

the drafts comply in all other respects with the terms of the law and the regulations.

(Ruling, Federal Reserve Bulletin, March, 1921, page 308.)

A member bank may properly accept a draft drawn against the shipment of goods from a corporation to its agent or branch even though no sale of the goods is involved in the transaction.

Shipment without sale

In any case where a draft is drawn against a shipment of goods in a transaction which does not involve the sale of those goods, the maturity of the draft should approximate the duration of their transit. In such a case the law contemplates that the acceptance of the draft should be for the purpose of financing the shipment, and that it should not be the means of furnishing a credit for any other purpose.

(Ruling, Federal Reserve Bulletin, September, 1917, page 690.)

The Board has ruled that a national bank may accept a draft drawn upon it if secured at the time of acceptance by a bill of lading covering a shipment of cattle to a cattle raiser who has purchased them with the intention of fattening and reselling them. The period covered by the acceptance, however, should not be in excess of the period of credit which is usual and reasonably necessary to finance transactions of this character.

Shipment of cattle

(Ruling, Federal Reserve Bulletin, July, 1921, page 815.)

#### Shipping Documents.

Under the provisions of section 13, which authorizes any member bank to accept drafts based upon domestic shipments of goods, provided shipping documents conveying or securing title are attached, such documents must be made out or indorsed so

Character of documents

as to convey or secure title to the accepting bank.  
(Opinion of Counsel, Federal Reserve Bulletin, March, 1918, page 198.)

Documents  
not re-  
quired to  
be physically  
attached

A provision of section 13 which authorizes any member bank to accept drafts based upon the domestic shipment of goods, provided shipping documents are "attached," should not be construed so as to require that the documents be physically fastened to the draft. It is sufficient if the accepting bank has possession of the documents at the time of acceptance.

(Opinion of Counsel, Federal Reserve Bulletin, October, 1917, page 765.)

Custody of  
documents

It is entirely consistent with the purposes of the Act and a sufficient compliance with its terms if shipping documents are in the possession of the bank and the bank has a lien on the property represented by such documents at the time that such bill is accepted. If placed in the possession of the bank's agent and under the control of the bank such documents could clearly be considered as in the possession of the bank. Care should, however, be taken that the documents be held for account of the accepting bank by a third party who is in no way interested in the acceptance transaction. A trust receipt of the party for whom the acceptance is made would not be looked upon with favor by the Board.

(Ruling, Federal Reserve Bulletin, October, 1918, page 972.)

#### Retention or Release of Documents against Acceptance.

Release of  
documents

Question is whether it is necessary, where a domestic acceptance is based upon a bill of lading, that the bank retain the bill of lading or other collateral during the life of the acceptance, or may the bank

release the bill of lading after acceptance. Also, whether the same rule will apply in case the acceptance is secured by a warehouse receipt.

Inasmuch as the statute merely requires the accepting bank to be secured in domestic transactions by shipping documents or warehouse receipts at the time of acceptance, the bank would no doubt have the right, if it became necessary to do so, to release either the shipping document or the warehouse receipt, provided the draft or drafts accepted for one person did not exceed ten per cent. of the capital and surplus of the accepting bank.

(Ruling, Federal Reserve Bulletin, July, 1918, page 634.)

A member bank can not accept in domestic transactions without being secured at the time of acceptance, but may release the security after acceptance upon the execution of a trust receipt or an agreement by the customer that so much of the proceeds of the sale of the goods covered by the security as may be necessary to pay the draft will be deposited with the accepting bank when available and will not be used for other purposes.

Customer's  
agreement

(Ruling, Federal Reserve Bulletin, February, 1919, page 143.)

The accepting bank may, if it chooses, release the security in any case in which the total amount accepted for any one customer does not exceed ten per cent. of its capital stock and surplus.

Release  
within  
10 per cent. limit

(Opinion of Counsel, Federal Reserve Bulletin, March, 1919, page 255.)

See also Regulation A, Series of 1920, B, pages 135-137, below.

## MATURITY

### Statutory Provisions

Maturity not to exceed six months

Any member bank may accept drafts or bills of exchange drawn upon it having not more than six months' sight to run, exclusive of days of grace.

(Federal Reserve Act, Section 13.)

### Opinions and Rulings

Credit agreement for more than six months

While a letter of credit or credit agreement may be lawfully made by a national bank which will extend by its terms for a period exceeding six months, the agreement must not be of such a character as will impose upon the holders of the drafts accepted thereunder any obligation to renew such drafts so that the period of acceptance shall exceed six months in duration as to any specified draft.

(Ruling, Federal Reserve Bulletin, September, 1915, page 269.)

Determination of maturity

Where a six months' credit is required it is improper to grant that credit by means of two three months' acceptances for the purpose of making the acceptances at all times eligible for rediscount by Federal reserve banks. On the other hand, the period covered by an acceptance should not be in excess of that which is usual and reasonably necessary to finance the underlying transaction.

(Ruling, Federal Reserve Bulletin, March, 1921, page 308.)

Renewal acceptances

No national bank may properly accept the renewal of a draft drawn by the purchaser of goods and secured at the time of original acceptance by a bill of lading or warehouse receipt unless the renewal acceptance complies with the terms of the law and the rulings and regulations of the Board applicable to the original acceptance.

(Opinion of Counsel, Federal Reserve Bulletin, January, 1920, page 66.)

In any case where a draft is drawn against a shipment of goods in a transaction which does not involve the sale of those goods, the maturity of the draft should approximate the duration of their transit. In such a case the law contemplates that the acceptance of the draft should be for the purpose of financing the shipment, and that it should not be the means of furnishing a credit for any other purpose.

Shipment without sale

(Ruling, Federal Reserve Bulletin, September, 1917, page 690.)

The period during which the acceptances are to run should have some relation to the period of time actually required for the shipment. The acceptance of drafts secured by bills of lading for the primary purpose of providing the borrower with working capital during the period required to manufacture and resell the goods covered by the bills of lading is an abuse of the domestic acceptance privilege.

Drafts to finance shipment only

(Ruling, Federal Reserve Bulletin, December, 1920, page 1801.)

## AMOUNT BANK MAY ACCEPT FOR ONE INTEREST

See "Bank Acceptances Based on Imports and Exports," pages 21-28, above.

## AGGREGATE AMOUNT BANK MAY ACCEPT

### Statutory Provisions

No bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half of its paid-up and unimpaired capital stock and surplus: *Provided, however, That the Federal Reserve Board, under such general regulations as it may prescribe, which shall apply to all banks*

Acceptances up to 100 per cent.

Domestic acceptances not to exceed 50 per cent.

Application of limit

Authority of Federal Reserve Board

alike regardless of the amount of capital stock and surplus, may authorize any member bank to accept such bills to an amount not exceeding at any time in the aggregate one hundred per centum of its paid-up and unimpaired capital stock and surplus:<sup>\*</sup> *Provided, further, That the aggregate of acceptances growing out of domestic transactions shall in no event exceed fifty per centum of such capital stock and surplus.*

(Federal Reserve Act, Section 13.)

#### Opinions and Rulings

The fifty per cent. limit relates to drafts or bills drawn against a bank in domestic transactions and accepted by that bank. It does not relate to drafts drawn by an individual against some other drawee which are accepted by the drawee and discounted by the bank.

The Federal Reserve Board is without authority to permit a member bank to accept drafts drawn against it in domestic transactions in excess of fifty per cent. of the capital and surplus of the accepting bank. It may authorize a member bank to accept drafts up to one hundred per cent., which amount may include both those which grow out of transactions involving the exportation or importation of goods and those which grow out of domestic transactions; but the statute limits specifically the amount that may be accepted in domestic transactions to fifty per cent. of the capital and surplus of the accepting bank.

(Ruling, Federal Reserve Bulletin, November, 1918, page 1119.)

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<sup>\*</sup>For regulations governing acceptance of domestic and foreign drafts up to an aggregate of one hundred per cent. of bank's capital and surplus, see "Bank Acceptances Based on Imports and Exports," pages 28-31, above.

When a member bank purchases its own acceptance before maturity such acceptance need not be included in the aggregate of acceptances authorized by section 13.

Purchase of  
bank's own  
acceptances

(Opinion of Counsel, Federal Reserve Bulletin, August, 1916, page 397. See also "Purchase by National Bank of its own Acceptances," pages 67-68, below.)

The limitations imposed by section 5202, Revised Statutes, on the liabilities incurred by any national bank do not apply to acceptances of such banks.

Section 5202  
does not apply  
to acceptances

(Opinion of Counsel, Federal Reserve Bulletin, December, 1916, page 680.)

Inasmuch as a commercial letter of credit is simply an agreement to make acceptances, and the authority of national banks to issue such letters of credit is incidental to the authority expressly granted by section 13 of the Act to make acceptances in certain transactions, and such letters may properly be issued only in connection with the kinds of transactions specified in that section, it seems clear that the liability of a member bank upon a commercial letter of credit is a liability incurred under the provisions of the Federal Reserve Act, and is not subject to the limitations of section 5202 of the Revised Statutes.

Letters of  
credit not  
limited by  
section 5202

The Board is further of the opinion that the liability incurred upon a commercial letter of credit—that is, upon the agreement or letter itself, as distinguished from the acceptances made thereunder—should not be classified as an acceptance liability within the limitation imposed upon the aggregate amount of acceptances outstanding at any one time under the provisions of section 13 of the Federal Reserve Act. It would seem that a member bank may issue a letter of credit, the aggregate amount

Letters of  
credit not  
limited by  
section 13

of which may be in excess of the fifty per cent. or one hundred per cent. of the bank's capital and surplus, provided that the aggregate amount of the acceptances made under the letter of credit and outstanding at any one time does not exceed, in addition to the bank's other outstanding acceptances, the aggregate limitation upon acceptances prescribed in section 13.

Reasonable  
limit

Nevertheless, a member bank should not obligate itself to accept drafts under a letter of credit to such an amount that it is reasonable to anticipate that the aggregate amount of acceptances issued under that letter and outstanding at any time, together with other acceptances which may be outstanding, will exceed at any one time the limitation to which the member bank is subject.

(Opinion of Counsel, Federal Reserve Bulletin, July, 1921, page 816.)

## **Bank Acceptances Secured by Warehouse Receipts**

### **CHARACTER**

#### **Statutory Provisions**

Any member bank may accept drafts or bills of exchange drawn upon it . . . which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples.

(Federal Reserve Act, Section 13.)

#### **Regulations of Federal Reserve Board**

A readily marketable staple . . . may be defined as an article of commerce, agriculture, or industry of such uses as to make it the subject of constant dealings in ready markets with such frequent quotations of price as to make (a) the price easily and definitely ascertainable and (b) the staple itself easy to realize upon by sale at any time.

Readily  
marketable  
staples

(Regulation C, Series of 1920, A, I, note.)

#### **Opinions and Rulings**

##### **Readily Marketable Staples.**

Although the law does not expressly restrict eligible staples to those which are nonperishable, nevertheless banks as a matter of prudence and protection to themselves should not consider as eligible any staple which is in its nature so perishable as not to be reasonably sure of maintaining its value as security at least for the life of the draft which is drawn against it.

Perishable  
staples

(Ruling, Federal Reserve Bulletin, July, 1919, page 652.)

No. 1425

New York, N.Y. June 1st. 1921

Monty does not offer discounts to the order of

THIRTY-SIXTEEN THOUSAND FOUR HUNDRED DOLLARS. 16400.00



THE SPECIMEN OF BANK ACCEPTANCE SECURED BY WAREHOUSE RECEIPTS.

Potatoes properly graded and packed and stored in a weather-proof and responsible warehouse, as evidenced by its receipt, would undoubtedly constitute a readily marketable nonperishable staple. **Potatoes**

(Ruling, Federal Reserve Bulletin, August, 1917, page 614.)

The term "staples" includes manufactured goods as well as raw materials, provided the goods are nonperishable and have a wide ready market. Cotton yarns and flour are held to be such staples. **Cotton yarns and flour**

(Ruling, Federal Reserve Bulletin, October, 1916, page 523.)

A warehouse receipt covering whiskey in bond which can be removed only for very specific and limited purposes is not a receipt conveying or securing title to "readily marketable staples" within the meaning of that section. **Whiskey in bond**

(Ruling, Federal Reserve Bulletin, May, 1920, page 494.)

The Board is of the opinion that a warehouse receipt covering wine in bond, whether intended for sacramental or other purposes, can not be considered a receipt conveying or securing title to "readily marketable staples" within the meaning of section 13 of the Federal Reserve Act. **Sacramental wine**

(Ruling, Federal Reserve Bulletin, April, 1921, page 419.)

An automobile is not a readily marketable staple within the meaning of the definition. Automobile tires cannot properly be considered readily marketable staples. **Automobiles and tires**

(Ruling, Federal Reserve Bulletin, January, 1920, page 65.)

#### Eligible Security.

No draft which is secured by a warehouse receipt should properly be considered eligible for acceptance under the terms of section 13 of the Federal **Term of storage**

Reserve Act unless the goods covered by the warehouse receipt are being held in storage pending a reasonably immediate sale, shipment, or distribution into the process of manufacture.

(Ruling, Federal Reserve Bulletin, September, 1919, page 858.)

Foreign  
warehouse  
receipts

A draft drawn abroad, payable in the United States in dollars and secured by a warehouse receipt covering readily marketable staples stored in a warehouse located in a foreign country, is eligible for acceptance by a member bank.

(Opinion of Counsel, Federal Reserve Bulletin, August, 1919, page 740.)

Warehouse receipts  
to be issued by  
independent  
warehouses

Warehouse receipts offered as security for bills accepted by member banks must be issued by warehouses which are independent of the borrower.

Where a corporation is formed as a subterfuge for the purpose of evading the spirit of the Board's ruling, this fact should be taken into consideration by a member bank accepting the bill and by the Federal reserve bank to which it is offered for discount.

If the borrower exercises such control over the corporation issuing the warehouse receipt as to give him control over the goods in storage, the purpose of requiring a receipt of the independent warehouseman would be defeated. The corporation issuing such receipt must be organized in good faith as an independent corporation and its affairs must be administered by duly authorized officers and agents independent of the borrower.

(Ruling, Federal Reserve Bulletin, January, 1918, page 31.)

Relation between  
borrower and ware-  
house corporation

The requirements of the Board appear to have been met where a separate corporation has been

created and the warehouse receipts are issued by that corporation and not by the borrower. However, where both corporations have practically the same officers, the manager of the warehouse appointed to execute the receipts should not be an employee of the borrowing company, as the Board requires that the receipts should be issued by a company independent of the borrower, and this requirement should be met in substance as well as in form.

(Ruling, Federal Reserve Bulletin, September, 1918, page 862.)

A borrowing corporation takes receipts for goods and materials stored in a warehouse controlled by a separate corporation engaged solely in the warehouse business, the entire stock of which is owned by the prospective borrower.

If a representative of the accepting bank is given control of the warehouse under a proper resolution of the directors of the warehouse corporation, the fact that the stock of the corporation is owned by the borrower should not prevent the acceptance of drafts secured by the warehouse receipts.

Control of  
warehouse by  
acceptor's  
representative

It should be agreed, however, that if by any future action of the warehouse corporation an attempt is made to exercise control over the warehouse, the representative of the acceptor should have the right to move the goods and to place them in storage elsewhere at the expense of the warehouse corporation.

(Ruling, Federal Reserve Bulletin, September, 1918, page 862.)

A canned goods concern proposes to place part of its readily marketable goods and materials in storage with a lessee of part of its premises. The lessee is then to issue warehouse receipts to the

Warehouse receipts  
issued by lessee

owner of the goods, which receipts are to be used as security for drafts drawn against and accepted by a member bank.

If the premises in question are actually turned over to the lessee under a bona fide lease, the lessee being independent of the borrower and having entire custody and control of the goods, there would seem to be no objection to a member bank's accepting drafts against the security of warehouse receipts issued by such lessee. It should, however, be expressly understood and agreed that the borrower shall not have access to the premises except with the permission of the lessee and that he shall exercise no control of any sort over the goods against which warehouse receipts are issued. The warehouse receipts must, of course, be in form properly to convey and secure title to the bank.

(Ruling, Federal Reserve Bulletin, July, 1918, page 634.)

Receipt of custodian of wool as warehouse receipt

It being understood that wool is stored in buildings under control of custodian entirely independent of borrower, custodian's certificate or receipt, if issued in proper form to convey or secure title, may be treated as a warehouse receipt within the meaning of section 13 of the Federal Reserve Act and acceptance of member bank under such conditions would be eligible for rediscount.

(Ruling, Federal Reserve Bulletin, July, 1918, page 636.)

Acceptance of drafts against sugar in bond

It is the understanding of this office that sugar referred to is placed in bond under transit entry and warehouse receipt issued by collector in negotiable form, but sugar can not be withdrawn for domestic sale or consumption without special permission of Treasury Department. Board is of opinion that member banks may legally accept

drafts drawn against security of such warehouse receipt properly assigned.

(Ruling, Federal Reserve Bulletin, June, 1918, page 520.)

A draft drawn by a cooperative marketing association is eligible for acceptance when secured at the time of acceptance by a negotiable warehouse receipt covering nonperishable agricultural commodities to which the association has title and which are stored in independent warehouses.

Drafts of  
cooperative  
associations

(Ruling, Federal Reserve Bulletin, August, 1921, page 963.)

**Ineligible Security.**

Any draft which is drawn to carry goods for speculative purposes or for any indefinite period of time without the purpose to sell, ship, or manufacture within a reasonable time, should not be considered eligible for acceptance under the provisions of section 13. Such a draft would be merely a cloak to evade the restrictions of section 5200 of the Revised Statutes and is not one of the kinds which Congress intended to make eligible for acceptance.

Speculative  
storage

(Ruling, Federal Reserve Bulletin, September, 1919, page 858.)

A draft is drawn by a cotton factor and secured at the time of acceptance by a warehouse receipt covering cotton consigned to the factor for the purpose of sale. Any draft drawn under the circumstances described, where it appears that the proceeds are to be used not for a commercial purpose but for the purpose of lending to the factor's customers, is not eligible for acceptance by a member bank.

Drafts of  
cotton  
factor

(Ruling, Federal Reserve Bulletin, February, 1920, page 162.)

Cattle  
paper

Drafts or bills of exchange drawn in domestic transactions against a national bank can not, under authority of section 13, be accepted when secured by a chattel mortgage on cattle but only when accompanied by shipping documents or when secured by a warehouse receipt or other similar document conveying or securing title to readily marketable staples.

While cattle may be treated as readily marketable staples, a chattel mortgage is not considered a document similar to a warehouse receipt, since the borrower retains the possession of the goods and conveys to the bank only the legal title.

(Ruling, Federal Reserve Bulletin, April, 1918, page 309.)

Collateral  
notes secured  
by chattel  
mortgages

A national bank is not authorized to accept a draft secured by collateral notes which are in turn secured by chattel mortgages on cattle.

(Ruling, Federal Reserve Bulletin, September, 1917, page 690.)

Member banks are not authorized to accept drafts of a cattle-loan company secured by notes of the owner of the cattle, although such notes may be secured by a chattel mortgage executed by the owner of the cattle to the cattle-loan company and the notes and chattel mortgage accompany the draft at the time of acceptance.

(Opinion of Counsel, Federal Reserve Bulletin, September, 1918, page 871.)

## Bills of sale

A bill of sale is not a receipt similar to a warehouse or terminal receipt; it is merely in substance a chattel mortgage to goods in the hands of the drawer and not a receipt for goods sold in the hands of some third party "independent of the borrower."

(Opinion of Counsel, Federal Reserve Bulletin, December, 1916, page 684.)

The acceptance of a draft by a member bank against an acceptance agreement which purports to assign to the bank certain collateral security, but which does not specifically mention any security as assigned, is an ordinary accommodation acceptance, and is not authorized by law. Security not specified

(Opinion of Counsel, Federal Reserve Bulletin, April, 1918, page 311.)

**Substitution of Warehouse Receipts.**

It is held that there is no objection to permitting mills to substitute other warehouse receipts for cotton receipts during the life of an acceptance. Substitution

(Ruling, Federal Reserve Bulletin, January, 1917, page 30.)

For rulings governing the release of warehouse receipts after acceptance, see pages 36-37, above. See also Regulation A, Series of 1920, B, pages 135-137, below. Release

## MATURITY

Although a national bank may accept drafts drawn upon it having not more than six months' sight to run which are secured at the time of acceptance by a warehouse receipt conveying or securing title covering readily marketable staples, nevertheless, such an acceptance must not be made subject to any renewals. Acceptances subject to renewal

(Opinion of Counsel, Federal Reserve Bulletin, March, 1920, page 277.)

A member bank can not agree unconditionally to accept a renewal draft but can agree only to accept in the event that the renewal draft is eligible for acceptance under the terms of the law.

(Ruling, Federal Reserve Bulletin, August, 1921, page 964.)

See also "Bank Acceptances Based on Domestic Shipments of Goods," pages 38-39, above.

**AMOUNT BANK MAY ACCEPT FOR ONE INTEREST**

See "Bank Acceptances Based on Imports and Exports," pages 21-28, above.

**AGGREGATE AMOUNT BANK MAY ACCEPT**

See "Bank Acceptances Based on Domestic Shipments of Goods," pages 39-42, above.

## **Bank Acceptances Executed to Furnish Dollar Exchange**

### **CHARACTER**

#### **Statutory Provisions**

Any member bank may accept drafts or bills of exchange drawn upon it having not more than three months' sight to run, exclusive of days of grace, drawn under regulations to be prescribed by the Federal Reserve Board by banks or bankers in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange as required by the usages of trade in the respective countries, dependencies, or insular possessions.

Acceptances  
for dollar  
exchange

(Federal Reserve Act, Section 13.)

#### **Regulations of Federal Reserve Board**

Any member bank desiring to accept drafts drawn by banks or bankers in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange shall first make an application to the Federal Reserve Board setting forth the usages of trade in the respective countries, dependencies, or insular possessions in which such banks or bankers are located.

Application for  
permission  
to accept

If the Federal Reserve Board should determine that the usages of trade in such countries, dependencies, or possessions require the granting of the acceptance facilities applied for, it will notify the applying bank of its approval and will also publish

Conditions  
of approval

No. A 614

Buenos Aires, Argentina, June 1st 1921

Ninety days after sight pay to the order of

\$100,000.00

ASS'T. MGR. FOREIGN DEPT.  
ASS'T. ANT. DISHIELE

NATIONAL BANK OF COMMERCE NEW YORK  
PAYABLE NOVEMBER 1 - 1921

ONE HUNDRED DOLLARS

Value received and acknowledged to the account of  
to National Bank of Commerce  
New York  
New York

SPECIMEN OF ACCEPTED DRAFT DRAWN TO CREATE DOLLAR EXCHANGE.

in the Federal Reserve Bulletin the name or names of those countries, dependencies, or possessions in which banks or bankers are authorized to draw on member banks whose applications have been approved for the purpose of furnishing dollar exchange.

The Federal Reserve Board reserves the right to modify or on ninety days' notice to revoke its approval either as to any particular member bank or as to any foreign country or dependency or insular possession of the United States in which it has authorized banks or bankers to draw on member banks for the purpose of furnishing dollar exchange.

(Regulation C, Series of 1920, B, II.)

#### Announcements of Federal Reserve Board

The purpose of this Act and the regulation made pursuant thereto was to enable the American banks to provide dollar exchange in countries where the check is not the current means of remittance in payment of foreign debts, but where the three months' bankers' draft is generally used for that purpose.

The Board is informed that the bankers' custom of selling three months' drafts in preference to checks originated in countries where the mail connections were irregular and the foreign exchange market was a limited one, and where it would have been difficult for the drawing banker to be certain that he could find a cover against the checks drawn by him in time to forward it by the same mail, whereas, in drawing a three months' draft, he would feel assured of being able to forward remittances before his obligation fell due. Such conditions do not exist in relations between England and France and the United States.

(Announcement, Federal Reserve Bulletin, December, 1916, page 665.)

Purpose of law

Origin of trade usages which require such acceptances

Countries  
whose trade  
usages warrant  
such accept-  
ances

Under the provisions of section 13 of the Federal Reserve Act, which provides that member banks, with the approval of the Federal Reserve Board, may accept drafts for the purpose of furnishing dollar exchange, drawn upon them by banks or bankers located in foreign countries or dependencies or insular possessions of the United States in which it is determined that the usages of trade require such acceptance facilities, the Board has designated as such the following countries and insular possessions: Argentina, Bolivia, Brazil, British Guiana, British Honduras, Chile, Colombia, Costa Rica, Cuba, Dutch Guiana, Ecuador, French Guiana, Guatemala, Honduras, Nicaragua, Panama, Paraguay, Peru, Porto Rico, San Salvador, Santo Domingo, Trinidad, Uruguay, and Venezuela.

(Announcement, Federal Reserve Bulletin, November, 1920, page 1175.)

Member banks with the approval of the Federal Reserve Board may accept drafts for the purpose of furnishing dollar exchange drawn upon them by banks or bankers located in Australia, New Zealand and other Australasian dependencies. [Special application is required in these cases.]

(Announcement, Federal Reserve Bulletin, February, 1921, page 188.)

#### Opinions and Rulings

Central and  
South America

Permission  
extended

The Federal Reserve Board has not rescinded its vote to permit member banks to accept drafts drawn upon them by banks or bankers in any Central or South American country for the purpose of creating dollar exchange. Permission granted to a member bank with respect to any country entitles it to exercise similar accepting powers with respect to all countries that have been or may hereafter be

designated by the Board as countries whose usages of trade require the furnishing of dollar exchange.

(Ruling, Federal Reserve Bulletin, November, 1918, page 1119.)

If a national bank wishes to accept drafts for the purpose of furnishing dollar exchange with respect to a country as to which no previous application has been granted, it should submit to the Board evidence that the usages of trade in that country are such as to require the drawing of drafts of this character. An application can not be granted, therefore, if it appears that the drafts are to be drawn not because the usages of trade so require but merely because dollar exchange is at a premium in the country where the drafts are to be drawn. This ruling, of course, has no bearing upon the question of whether particular drafts are eligible for acceptance by member banks as drafts which grow out of transactions involving the importation or exportation of goods.

Application  
with respect  
to other  
countries

(Ruling, Federal Reserve Bulletin, August, 1920, page 885.)

## MATURITY

### Statutory Provisions

Any member bank may accept drafts or bills of exchange drawn upon it [to furnish dollar exchange] having not more than three months' sight to run, exclusive of days of grace.

Maturity not to  
exceed three  
months

(Federal Reserve Act, Section 18.)

## AMOUNT MEMBER BANK MAY ACCEPT FOR ONE INTEREST

### Statutory Provisions

No member bank shall accept such drafts or bills of exchange referred to in this paragraph for any

Ten per cent.  
limit

one bank to an amount exceeding in the aggregate ten per centum of the paid-up and unimpaired capital and surplus of the accepting bank unless the draft or bill of exchange is accompanied by documents conveying or securing title or by some other adequate security.

(Federal Reserve Act, Section 13.)

#### **AGGREGATE AMOUNT MEMBER BANK MAY ACCEPT**

##### **Statutory Provisions**

**Fifty per cent.  
limit**

No member bank shall accept such drafts or bills in an amount exceeding at any time the aggregate of one-half of its paid-up and unimpaired capital and surplus.

(Federal Reserve Act, Section 13.)

##### **Regulations of Federal Reserve Board**

**Limit is ex-  
clusive**

This fifty per cent. limit is separate and distinct from and not included in the limits placed upon the acceptance of drafts and bills of exchange. . . . [drawn against domestic or foreign shipments or secured by warehouse receipts.]

(Regulation C, Series of 1920, B, I.)

##### **Opinions and Rulings**

**Section 5202  
not applicable**

The limitations imposed by section 5202, Revised Statutes, on the liabilities incurred by any national bank do not apply to acceptances of such banks.

(Opinion of Counsel, Federal Reserve Bulletin, December, 1916, page 680.)

## **Letters of Credit and Acceptances Issued for Correspondents**

### **Opinions and Rulings**

The Comptroller of the Currency has ruled, under section 5190, United States Revised Statutes, that a national bank located in California may not appoint an agent in New York to accept in behalf of the bank drafts drawn on it payable in New York and to pay such drafts out of the funds deposited in New York under the control of the agent.

**Agencies of  
national  
banks**

(Federal Reserve Bulletin, August, 1920, page 835.)

National banks for some time have been accustomed to guarantee letters of credit issued at their request by correspondent banks in large centers on behalf of the national bank's customers. For instance, it appears that where the customer of an inferior national bank desires to obtain a letter of credit in connection with his foreign business, the national bank, instead of issuing the letter itself, will get one of its large city correspondents to issue a letter for the customer's account, which the national bank guarantees; that is, the national bank agrees that in the event the customer for whose account the letter is issued fails to put the issuing bank in funds to meet the acceptances, the guaranteeing bank will do so. The transaction does not always involve the issuance of a letter of credit, for the correspondent bank sometimes simply accepts a draft drawn upon it by the national bank's customer, and the national bank, in a collateral agreement with the correspondent bank, guarantees the

**Guarantee of  
letters  
of credit**

**Guarantee of  
acceptances**

customer's obligation to put the correspondent bank in funds to meet the acceptance. Under the latter arrangement, the national bank's liability is the same as the ultimate liability which arises out of guaranteeing a letter of credit, so that the two transactions will be considered as one and the same for the purposes of this discussion.

Ultra  
vires  
acts

Whether or not a national bank has authority to guarantee a letter of credit is a question of law which in the last analysis must be determined by the courts. The Federal Reserve Board is of the opinion that a national bank has no authority to guarantee or act as surety upon a letter of credit; that such acts are ultra vires; and that if the directors of a national bank enter into such contracts of guaranty or suretyship, they assume in their personal capacities the risk of any loss that may occur.

Alternative  
method

The Board desires to suggest an alternative method of financing the business heretofore financed by means of letters of credit guaranteed by the national banks at whose request the letters are issued. The Board is of the opinion that this course, if adopted, will enable a national bank, with only slight modifications as to the manner of handling the business, to continue to carry it on without entering into an ultra vires transaction. Take the case of a national bank in an interior community, whose customer wishes to obtain a letter of credit which will be satisfactory to his foreign dealer. The national bank, having no international standing, or being without any department capable of handling foreign business, does not wish to issue the letter itself but is willing to extend its credit to its customer. Under these circumstances, it enters into an arrangement with, say, its New York corre-

spondent, whereby the New York correspondent <sup>Agency agreement</sup> agrees as agent of the interior bank to issue a letter of credit for the account of the interior bank's customer, the letter to be issued in the name of the New York correspondent, but in issuing the letter the New York correspondent is to act as agent for an undisclosed principal, namely, the interior bank. The interior bank's name will not appear on the letter of credit, but its New York correspondent may look to it for reimbursement under the collateral agency agreement, not conditionally upon the failure of the customer to put the issuing bank in funds but directly and unconditionally as the real issuer of the letter. The beneficiary of the letter and the holders of the acceptances drawn thereunder will look to and rely on the credit of the New York bank, for its name alone will appear on the letter and the acceptances, but the interior bank will in fact be the real acceptor and the customer will be under obligation to put the interior bank, not the New York bank, in funds to meet the acceptances as they mature. The only change necessary in the present method is that the interior bank, instead of guaranteeing the letter of credit, will execute a separate contract appointing its New York correspondent its agent, and agreeing unconditionally to reimburse the agent as such for any moneys paid out, or, if desired, to put the agent in funds to meet the acceptances as they mature. It would seem that this procedure will meet the practical requirements of the situation and at the same time avoid the necessity of any contract of guaranty.

The Board is of the opinion that the provisions of section 5190 do not necessarily prevent a national <sup>Agent for specific purpose</sup>

bank from appointing another bank or banker as its agent to issue a letter of credit in the agent's name. It is well recognized that, while a national bank may not transact any part of its "usual business" at another place through an agent, nevertheless it may appoint an agent for specific purposes or to transact particular kinds of business. Under these circumstances, it would seem that a national bank, for the purpose of financing its customer's business in the manner herein suggested, may appoint a domestic or foreign bank or banker as its agent to issue in the agent's own name a letter of credit and to accept drafts drawn thereunder, provided, that the authority conferred is specifically limited to the particular transaction involved and that a definite limitation is imposed upon the amount of each letter of credit.

Liabilities  
of principal  
and agent

In case the course suggested should be adopted, the agent bank, which issues the letter and which is primarily and unconditionally liable upon the acceptances made thereunder, must include the liability on such acceptances, as and when incurred, among its general acceptance liabilities subject to the limitations on the acceptance power prescribed by law; and, inasmuch as the interior bank is by hypothesis the real acceptor and is directly and unconditionally liable to the agent bank for any moneys paid out to meet the acceptances as they mature or to put the accepting bank in funds to meet such acceptances, the principal bank also must include the amount of the acceptances, as and when made, among its general acceptance liabilities subject to the limitations of law.

It should be remembered that the foregoing merely represents the Board's opinion as to the

legality of the proposed plan, and as to the requirements which must be complied with if national banks see fit to adopt the plan. In the last analysis, the question whether a national bank legally may appoint a correspondent as its agent in particular transactions to issue a letter of credit and to accept drafts drawn thereunder, and whether in other respects a national bank legally may transact the business in the manner suggested, is a question for the determination of the courts. It seems advisable, however, for the Board to set forth its views with regard to the matter under discussion in order that its position may be clearly understood.

Question  
of law

This opinion has been submitted to the Comptroller of the Currency and he concurs in the views expressed therein.

(Federal Reserve Bulletin, May, 1921, page 547.)

## Investment in Bank Acceptances by National Banks

### Statutory Provisions

**Section 5200,  
Revised Statutes**

**Ten per cent.  
limit on loans  
to one interest**

**Bills of  
exchange  
and bank  
acceptances**

**Business  
paper**

**Documentary  
notes**

The total liabilities to any association of any person or of any company, corporation, or firm for money borrowed, including in the liabilities of a company or firm the liabilities of the several members thereof, shall at no time exceed ten per centum of the amount of the capital stock of such association, actually paid in and unimpaired, and ten per centum of its unimpaired surplus fund: *Provided, however,* That (1) the discount of bills of exchange drawn in good faith against actually existing values, including drafts and bills of exchange secured by shipping documents conveying or securing title to goods shipped, and including demand obligations when secured by documents covering commodities in actual process of shipment, and also including bankers' acceptances of the kinds described in section 13 of the Federal Reserve Act, (2) the discount of commercial or business paper actually owned by the person, company, corporation, or firm negotiating the same, (3) the discount of notes secured by shipping documents, warehouse receipts, or other such documents conveying or securing title covering readily marketable nonperishable staples, including live stock, when the actual market value of the property securing the obligation is not at any time less than 115 per centum of the face amount of the notes secured by such documents and when such property is fully covered by insurance, and (4) the discount of any note or notes secured by

not less than a like face amount of bonds or notes of the United States issued since April 24, 1917, or certificates of indebtedness of the United States, shall not be considered as money borrowed within the meaning of this section. The total liabilities to any association, of any person or of any corporation, or firm, or company, or the several members thereof upon any note or notes purchased or discounted by such association and secured by bonds, notes, or certificates of indebtedness as described in (4) hereof shall not exceed (except to the extent permitted by rules and regulations prescribed by the Comptroller of the Currency, with the approval of the Secretary of the Treasury) ten per centum of such capital stock and surplus fund of such association and the total liabilities to any association of any person or of any corporation, or firm, or company, or the several members thereof for money borrowed, including the liabilities upon notes secured in the manner described under (3) hereof, except transactions (1), (2), and (4), shall not at any time exceed twenty-five per centum of the amount of the association's paid-in and unimpaired capital stock and surplus. The exception made under (3) hereof shall not apply to the notes of any one person, corporation or firm or company, or the several members thereof for more than six months in any consecutive twelve months.

Notes  
secured by  
United  
States war  
obligations

Limitation on  
documentary  
loans

(National Bank Act, Section 5200, Revised Statutes, as amended October 22, 1919.)

### Opinions and Rulings

#### Purchase or Discount of Acceptances of Other Banks.

“Bills of exchange” may be taken as including

“Bills of  
exchange” include  
bank acceptances

acceptances, since a bill does not lose its characteristics as such when accepted by the drawee.

(Opinion of Counsel, Federal Reserve Bulletin, March, 1917, page 195.)

**Bills discounted before acceptance**

A bill of exchange discounted before acceptance may be said to be drawn against actually existing value only when it is accompanied by shipping documents, warehouse receipts, or other papers securing title to the goods sold.

(Opinion of Counsel, Federal Reserve Bulletin, March, 1917, page 195.)

**Secured by shipping documents or pledge of goods**

A bill secured by shipping documents, or by the pledge of goods actually sold, might be discounted by a member bank before acceptance without being subject to the limitations imposed by section 5200, since this would constitute a bill drawn in good faith against actually existing value.

(Opinion of Counsel, Federal Reserve Bulletin, December, 1916, page 688.)

**Discount of acceptances as business paper**

The Board finds it necessary to adhere to its established policy of not making any general ruling on the question of how much a bank may invest in any particular security. It holds, however, that if a firm is a bona fide owner for value of the acceptances of any particular institution and such acceptances are sold to or discounted with a member bank, the acceptances could no doubt be treated as commercial or business paper actually owned by the party negotiating them and would therefore be excepted from the limitation of section 5200, Revised Statutes.

(Ruling, Federal Reserve Bulletin, December, 1916, page 678.)

A bill rediscounted in good faith by a member bank, which is no longer owned or held by the bank, need not be included as a liability of the maker to the bank within the meaning of section 5200, Revised Statutes. Bills rediscounted under an agreement to repurchase, or which are merely credited to the account of the bank offering them for rediscount, are subject to the limitations of section 5200.

Rediscounted paper not limited by section 5200

(Opinion of Counsel, Federal Reserve Bulletin, September, 1918, page 867.)

It appears that some national banks, in consideration of a fee or commission, are accustomed to indorse acceptances for the accommodation of their customers or bill brokers. Whether or not a national bank has authority to indorse an acceptance for accommodation is a question of law which in the last analysis must be determined by the courts. The Federal Reserve Board is of the opinion that a national bank has no authority to indorse an acceptance for accommodation, and that such act is ultra vires.

Indorsement for accommodation

However, a national bank may purchase an acceptance and immediately resell it with its indorsement, since the power to indorse acceptances is incidental to the power to negotiate acceptances. There appears to be no authority of law which permits a national bank to lend its credit by indorsing an acceptance where the transaction does not involve an actual transfer of title to and from the national bank.

(Opinion of Counsel, Federal Reserve Bulletin, May, 1921, page 547.)

#### Purchase by National Bank of its own Acceptances.

A member bank may legally purchase its own acceptances, but such a transaction is equivalent to

Bank may purchase its own acceptances

a loan or advance to the customer for whom the acceptance was made and the liability of such customer becomes subject to the limitations of section 5200, Revised Statutes.

(Opinion of Counsel, Federal Reserve Bulletin, December, 1916, page 680.)

**Exemption from  
limitations of  
section 13**

When a bank purchases its own acceptance before maturity such acceptance need not be included in the aggregate of acceptances authorized by section 13.

(Opinion of Counsel, Federal Reserve Bulletin, August, 1916, page 397.)

**Reissuance of  
acceptances**

While the Board has ruled that when a bank buys its own acceptances they are to be recorded as loans subject to the limitations of section 5200, the right of the bank to resell or reissue the acceptance is, in the opinion of counsel, fully recognized by the authorities, and where this is done they may be treated as acceptances outstanding and not as loans.

(Opinion of Counsel, Federal Reserve Bulletin, September, 1917, page 691.)

**Rediscount of  
such acceptances**

An acceptance which has been purchased by the accepting bank and subsequently rediscounted with its Federal reserve bank is not subject to the limitations of section 5200 of the Revised Statutes.

(Opinion of Counsel, Federal Reserve Bulletin, September, 1917, page 696.)

## PART II.

### Rediscounts with Federal Reserve Banks

#### General Statutory Provisions

Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice and protest by such bank as to its own indorsement exclusively, any Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act. Nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise, from being eligible for such discount; but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States. Notes, drafts, and bills admitted to discount under the terms of this paragraph must have a maturity at the time of discount of not more

Notes, drafts, and bills of exchange

Commercial paper

Agricultural and commodity paper

Ineligible paper

Maturity of eligible paper

than ninety days, exclusive of days of grace: *Provided*, That notes, drafts, and bills drawn or issued for agricultural purposes or based on live stock and having a maturity not exceeding six months, exclusive of days of grace, may be discounted in an amount to be limited to a percentage of the assets of the Federal reserve bank, to be ascertained and fixed by the Federal Reserve Board.

Amount rediscoun-  
table by one bank  
bearing signature  
of any one interest

The aggregate of such notes, drafts, and bills bearing the signature or indorsement of any one borrower, whether a person, company, firm, or corporation, rediscounted for any one bank, shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank; but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values.

Bank acceptances  
eligible for  
rediscount

Any Federal reserve bank may discount acceptances of the kinds hereinafter described,\* which have a maturity at the time of discount of not more than three months' sight, exclusive of days of grace, and which are indorsed by at least one member bank.

Subject to reg-  
ulations of  
Federal Reserve  
Board

The discount and rediscount and the purchase and sale by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board.

Such drafts or bills [to provide dollar exchange]

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\* See Part I, "General Statutory Provisions," pages 9-10, above.

may be acquired by Federal reserve banks in such amounts and subject to such regulations, restrictions, and limitations as may be prescribed by the Federal Reserve Board.

(Federal Reserve Act, Section 18.)

No Federal reserve bank shall be permitted to discount for any [member] State bank or trust company notes, drafts, or bills of exchange of any one borrower who is liable for borrowed money to such State bank or trust company in an amount greater than ten per centum of the capital and surplus of such State bank or trust company, but the discount of bills of exchange drawn against actually existing value and the discount of commercial or business paper actually owned by the person negotiating the same shall not be considered as borrowed money within the meaning of this section. The Federal reserve bank, as a condition of the discount of notes, drafts, and bills of exchange for such State bank or trust company, shall require a certificate or guaranty to the effect that the borrower is not liable to such bank in excess of the amount provided by this section, and will not be permitted to become liable in excess of this amount while such notes, drafts, or bills of exchange are under discount with the Federal reserve bank.

Rediscounts  
for member  
State banks

Conditions

(Federal Reserve Act, Section 9.)

Upon the affirmative vote of not less than five of its members, the Federal Reserve Board shall have power to permit Federal reserve banks to discount for any member bank notes, drafts, or bills of exchange bearing the signature or endorsement of any one borrower in excess of the amount permitted by section 9 and section 13 of this Act, but in no case to exceed twenty per centum of the member bank's

Rediscounts  
of war paper  
until October  
31, 1921

capital and surplus: *Provided, however,* That all such notes, drafts, or bills of exchange discounted for any member bank in excess of the amount permitted under such sections shall be secured by not less than a like face amount of bonds or notes of the United States issued since April 24, 1917, for which the borrower shall in good faith prior to January 1, 1921, have paid or agreed to pay not less than the full face amount thereof, or certificates of indebtedness of the United States: *Provided further,* That the provisions of this subsection (m) shall not be operative after October 31, 1921.

(Federal Reserve Act, Section 11 (m).)

Security of  
War Finance  
Corporation  
bonds

The Federal reserve banks shall be authorized, subject to the maturity limitations of the Federal Reserve Act and to regulations of the Federal Reserve Board, . . . to rediscount eligible paper secured by . . . bonds [of the War Finance Corporation] and indorsed by a member bank. No discount or rediscount under this section shall be granted at a less interest charge than one per centum per annum above the prevailing rates for eligible commercial paper of corresponding maturity.

(War Finance Corporation Act, Section 13.)

Procuring dis-  
counts for  
nonmembers

No member bank shall act as the medium or agent of a nonmember bank in applying for or receiving discounts from a Federal reserve bank under the provisions of this Act, except by permission of the Federal Reserve Board.

(Federal Reserve Act, Section 19.)

Aggregate  
accommodations

Said board [of directors of each Federal reserve bank] shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks

and shall, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks.

(Federal Reserve Act, Section 4.)

### General Regulations of Federal Reserve Board

#### SUMMARY OF STATUTORY PROVISIONS

Any Federal reserve bank may discount for any of its member banks any note, draft, or bill of exchange, provided—

(a) It has a maturity at the time of discount Maturity of not more than ninety days, exclusive of days of grace; but if drawn or issued for agricultural purposes or based on live stock, it may have a maturity at the time of discount of not more than six months, exclusive of days of grace.

(b) It arose out of actual commercial transactions; that is, it must be a note, draft, or bill of exchange which has been issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used or are to be used for such purposes. Commercial character

(c) It was not issued for carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States. Finance paper ineligible

(d) The aggregate of notes, drafts, and bills bearing the signature or indorsement of any one borrower, whether a person, company, firm, or corporation, rediscounted for any one member bank, whether State or National, shall at no time exceed Ten per cent. limit

ten per cent.\* of the unimpaired capital and surplus of such bank; but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values.

**Indorsement**

- (e) It is indorsed by a member bank.
- (f) It conforms to all applicable provisions of this regulation.

**Rediscounts  
for member  
State banks**

No Federal reserve bank may discount for any member State bank or trust company any of the notes, drafts, or bills of any one borrower who is liable for borrowed money to such State bank or trust company in an amount greater than ten per cent.† of the capital and surplus of that State

\* Under the terms of Section 11 (m) as amended by the Act of February 27, 1921, a Federal reserve bank may, until October 31, 1921, rediscount for any member bank, whether State or National, notes, drafts, and bills bearing the signature or indorsement of any one borrower in an amount not to exceed twenty per cent. of the member bank's capital and surplus, provided that the excess over and above ten per cent. be secured by not less than a like face amount of bonds or notes of the United States issued since April 24, 1917, for which the borrower shall in good faith prior to January 1, 1921, have paid, or agreed to pay, not less than the full face amount thereof, or certificates of indebtedness of the United States. (As amended in effect by Act of February 27, 1921.)

†Under the terms of Section 11 (m) as amended by the Act of February 27, 1921, a Federal reserve bank may, until October 31, 1921, rediscount for a member State bank or trust company paper of any one borrower secured by not less than a like face amount of bonds or notes of the United States issued since April 24, 1917, for which the borrower shall in good faith prior to January 1, 1921, have paid, or agreed to pay, not less than the full face amount thereof, or certificates of indebtedness of the United States, even though such State bank or trust company may already have loaned to the borrower under his regular line of credit in excess of the ten per cent. limit defined above. If, however, the member State bank or trust company has loaned to one borrower in excess of that ten per cent. limit under his regular line of credit, the Federal reserve bank cannot rediscount for that State bank or trust company any of the paper of that borrower taken

bank or trust company, but in determining the amount of money borrowed from such State bank or trust company the discount of bills of exchange drawn in good faith against actually existing value and the discount of commercial or business paper actually owned by the person negotiating the same shall not be included.

(Regulation A, Series of 1920, A, I.)

### ELIGIBILITY OF NOTES, DRAFTS, AND BILLS OF EXCHANGE

The Federal Reserve Board, exercising its statutory right to define the character of a note, draft, or bill of exchange eligible for rediscount at a Federal reserve bank, has determined that—

(a) It must be a note, draft, or bill of exchange which has been issued or drawn, or the proceeds of which have been used or are to be used in the first instance, in producing, purchasing, carrying, or marketing goods\* in one or more of the steps of the process of production, manufacture, or distribution, or for the purpose of carrying or trading in bonds or notes of the United States. Commercial paper

(b) It must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for permanent or fixed investments of any kind, such as land, buildings, or machinery, or for any other capital purpose. Finance paper ineligible

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under that regular line of credit, but may rediscount any paper so secured by Government obligations of the kinds specified, acquired under the conditions set forth above, up to an amount not in excess of twenty per cent. of the capital and surplus of such State bank or trust company. (As amended in effect by Act of February 27, 1921.)

\* When used in this regulation the word "goods" shall be construed to include goods, wares, merchandise, or agricultural products, including live stock.

(c) It must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for investments of a purely speculative character or for the purpose of lending to some other borrower.

**Collateral security**

(d) It may be secured by the pledge of goods or collateral of any nature, including paper, which is ineligible for rediscount, provided it (the note, draft, or bill of exchange) is otherwise eligible.

(Regulation A, Series of 1920, A, II.)

### APPLICATIONS FOR REDISCOUNT

**Certificate of member bank**

All applications for the rediscount of notes, drafts, or bills of exchange must contain a certificate of the member bank, in form to be prescribed by the Federal reserve bank, that, to the best of its knowledge and belief, such notes, drafts, or bills of exchange have been issued for one or more of the purposes . . . [of producing, purchasing, carrying or marketing goods, or of carrying or trading in United States obligations], and, in the case of a member State bank or trust company, all applications must contain a certificate or guaranty to the effect that the borrower is not liable, and will not be permitted to become liable during the time his paper is held by the Federal reserve bank, to such bank or trust company for borrowed money in an amount greater than . . . [ten per cent. of the capital and surplus of such bank or trust company].

**Member State bank**

(Regulation A, Series of 1920, A, III.)

## Rediscount of Promissory Notes

### DEFINITION OF NOTE

A promissory note, within the meaning of this regulation, is defined as an unconditional promise, in writing, signed by the maker, to pay, in the United States, at a fixed or determinable future time, a sum certain in dollars to order or to bearer.

(Regulation A, Series of 1920, A, IV.)

### ELIGIBLE CLASSES OF NOTES

#### Statutory Provisions

Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice and protest by such bank as to its own indorsement exclusively, any Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act. Nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise, from being eligible for such discount; [or] . . . notes, drafts, or bills . . . issued or drawn for the purpose of carrying or trading in . . . bonds and notes of the Government of the United States.

Commercial paper

Agricultural and commodity paper

Paper based on United States obligations

(Federal Reserve Act, Section 13.)

Paper secured  
by bonds of  
War Finance  
Corporation

The Federal reserve banks shall be authorized . . . to rediscount eligible paper secured by . . . bonds [of the War Finance Corporation] and indorsed by a member bank. No discount or rediscount under this section shall be granted at a less interest charge than one per centum per annum above the prevailing rates for eligible commercial paper of corresponding maturity.

(War Finance Corporation Act, Section 13.)

#### Regulations of Federal Reserve Board

The Federal Reserve Board, exercising its statutory right to define the character of a note, draft, or bill of exchange eligible for rediscount at a Federal reserve bank, has determined that—

It must be a note, draft, or bill of exchange which has been issued or drawn, or the proceeds of which have been used or are to be used in the first instance, in producing, purchasing, carrying, or marketing goods\* in one or more of the steps of the process of production, manufacture, or distribution, or for the purpose of carrying or trading in bonds or notes of the United States.

It may be secured by the pledge of goods or collateral of any nature, including paper, which is ineligible for rediscount, provided it (the note, draft, or bill of exchange) is otherwise eligible.

(Regulation A, Series of 1920, A, II.)

#### Opinions and Rulings

There are two general classes of eligible agricultural and commercial paper—(1) paper which is eligible because issued or drawn for an agricultural

Commercial  
paper

Collateral  
notes

Classes of  
eligible paper

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\* When used in this regulation the word "goods" shall be construed to include goods, wares, merchandise, or agricultural products, including live stock.

or commercial purpose, and (2) paper which is eligible because the proceeds have been or are to be used for an agricultural or commercial purpose.

A note of a buyer given to the seller in payment for articles purchased is a note which has been issued or drawn for a commercial purpose. If a note is not issued or drawn for such a purpose, its eligibility or ineligibility for rediscount must be determined by the purpose for which the proceeds have been or are to be used. The use of proceeds to purchase goods for resale is a commercial purpose, even though the articles must be considered permanent investments in the hands of those who ultimately purchase them.

Commercial purpose

Use of proceeds

The purchase and sale of any articles or commodities including agricultural products is a commercial rather than an agricultural transaction. Consequently, the note of a dealer, whether it is given in payment for articles or commodities purchased for resale, or is discounted by the dealer at his bank to provide funds with which to purchase such articles or commodities, can be eligible for rediscount only as commercial paper. So also a note given to a farmer in payment for agricultural products grown by him cannot be eligible for rediscount as agricultural paper but may be eligible as commercial paper.

Commercial and agricultural paper distinguished

Whether the buyer makes his own note or accepts a draft drawn on him by a seller, the same principles will apply in determining whether the instrument representing the buyer's obligation is commercial paper or agricultural paper.

Rules applicable to drafts

Even though a bill or note may technically be eligible for rediscount, a Federal reserve bank is

No obligation to rediscount

**under no obligation to rediscount it but may exercise its discretionary power.**

(Ruling, Federal Reserve Bulletin, December, 1920, page 1301; October, 1921, page 1199.)

**Loans to individuals**

Federal reserve banks do not make loans directly to individuals, but rediscount the paper of member banks, which include all national banks and such State banks as may have joined the Federal Reserve System.

(Ruling, Federal Reserve Bulletin, June, 1916, page 272.)

**Discretion of reserve banks**

Even though a note may be technically eligible for rediscount, a Federal reserve bank may in its discretion decline to effect its rediscount, if for any reason it is deemed to be an undesirable investment, and should do so in any case where the ultimate payment of the note is dependent upon the success of the transaction giving rise to the note.

(Ruling, Federal Reserve Bulletin, July, 1920, page 699.)

**Test of eligibility**

The test of the eligibility of paper is whether it complies with the terms of the Federal Reserve Act and the Board's regulations, and this in turn involves the question of the use of the proceeds. In the last analysis this is a question of fact and its determination is the function of the reserve banks rather than of the Federal Reserve Board.

(Ruling, Federal Reserve Bulletin, November, 1920, page 1176.)

**Paper of waterworks company**

The ninety-day paper of a waterworks company, the proceeds of which have been or are to be used to provide funds for payroll, purchases of coal, etc., is eligible for rediscount by a Federal reserve bank if the paper is otherwise in conformity with the law and the provisions of the Board's regulations.

(Ruling, Federal Reserve Bulletin, July, 1917, page 527.)

Water actually sold and delivered by an irrigation company to farmers who have contracted with the company for its delivery may be considered "goods sold," or in other words, the sale of water in this manner is a commercial transaction. Consequently, the note of the irrigation company, the proceeds of which have been or are to be used for payroll or other current purposes in connection with the distribution of the water to the farmers, is eligible for rediscount.

Paper of  
irrigation  
company

(Ruling, Federal Reserve Bulletin, September, 1920, page 949.)

If the note of an owner or producer is given in good faith to a contractor in actual payment of materials and services furnished by him for the owner or producer, it may be considered technically eligible for rediscount as paper, the proceeds of which have been or are to be used for a commercial or industrial purpose. The paper in the hands of the contractor is commercial or business paper actually owned by him.

Notes for  
material

(Ruling, Federal Reserve Bulletin, July, 1920, page 699.)

It is impossible to make any general ruling that cotton factors' paper, as such, is eligible or ineligible for rediscount. On the one hand, paper the proceeds of which are used to lend to some third party is finance paper rather than commercial paper and is in consequence ineligible for rediscount even though that third party may use the proceeds for a commercial purpose. On the other hand, any paper the proceeds of which are used to purchase goods to sell to some third party is eligible for rediscount as commercial paper.

Cotton  
factors'  
paper

Whether or not a given transaction falls within one class or the other is solely a question of fact

for the determination of the directors of the Federal reserve bank to which the paper is presented for rediscount. The mere fact that a borrower on a given note is a cotton factor does not of itself render that note ineligible since its eligibility is a matter to be determined by the use to which the proceeds of that particular note are put.

(Ruling, Federal Reserve Bulletin, November, 1919, page 1054.)

Notes owned  
by cotton  
factors

If a cotton factor's loans to customers are evidenced by the customers' notes, these notes could be indorsed and discounted by the factor and might then be eligible for rediscount upon satisfactory evidence that the proceeds of the loans have been or are to be used for agricultural or commercial purposes. Moreover, when a factor sells cotton on credit terms which are customary and which are not unnecessarily or unreasonably long, a note or accepted draft for the amount of the purchaser's obligation will have been issued or drawn for a commercial purpose and may be eligible for rediscount.

(Ruling, Federal Reserve Bulletin, November, 1920, page 1176.)

Notes for  
trucks  
purchased

A note given by a corporation furnishing motor transportation to the seller in payment for motor trucks purchased is commercial paper in the hands of the seller and may therefore be eligible for rediscount after it has been discounted by the seller.

(Ruling, Federal Reserve Bulletin, February, 1921, page 191.)

Discount of  
renewal notes

Renewals differ, and banking judgment determines the merits of each particular case. Self-liquidating paper, even though the transaction which gives rise to it does not liquidate itself within the ninety-day maturity, might be discounted even

though it appears to be renewal paper. Banks should not enter into an agreement for a renewal. Care should be exercised in examining such paper and the transactions which give rise to it, but mechanical rules should not be allowed to take the place of discriminating banking judgment.

(Ruling, Federal Reserve Bulletin, June, 1915, page 74.)

Paper of equity exchange

Paper of equity exchanges, if first discounted by a member bank, would be in form eligible for rediscount at the Federal reserve bank, provided its maturity at the time of discount does not exceed ninety days. Their paper must, however, first have been discounted with a member bank and the member bank alone would have the right to rediscount this paper with the Federal reserve bank.

(Ruling, Federal Reserve Bulletin, May, 1917, page 379.)

Notes owned by cold storage company

The notes of customers of a cold storage company representing loans made to them by the company might be eligible for rediscount if the customers have used or are to use the proceeds for agricultural or commercial purposes.

(Ruling, Federal Reserve Bulletin, March, 1921, page 309.)

#### Secured Notes.

Effect of security

Section 13 provides in part that "nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount." This provision is merely a declaration that paper which is eligible for rediscount by reason of the use of the proceeds is not made ineligible by reason of being secured. The provision cannot be construed to make eligible for rediscount paper which is secured in the manner specified but which

is not eligible commercial or agricultural paper as defined in the preceding part of the section.

(Ruling, Federal Reserve Bulletin, November, 1920, page 1177.)

**Eligibility tested by  
use of funds**

Under section 13 of the Federal Reserve Act the eligibility of a note for rediscount is determined by the use of the funds derived from the original negotiation of the note. The collateral security of the note may indicate its use, but the form of collateral is otherwise immaterial. In other words, a note might be secured by railroad stocks and bonds, but the proceeds might be used for an agricultural, industrial, or a commercial purpose, in which event the note would be eligible for rediscount, although it would not be if the proceeds were used to purchase or carry the railroad stocks and bonds.

(Opinion of Counsel, Federal Reserve Bulletin, December, 1917, page 954.)

**Collateral notes for  
commercial purposes**

Notes secured by collateral, the proceeds of which have been used or are to be used for commercial purposes, and which otherwise comply with the regulations, are eligible for rediscount.

The fact that commercial paper has the additional security of collateral in no way affects its eligibility for rediscount.

(Ruling, Federal Reserve Bulletin, September, 1915, page 268.)

**Eligible security not  
sufficient**

A note, even though secured by eligible paper, is not itself eligible for rediscount unless issued for an agricultural, commercial, or industrial purpose.

(Ruling, Federal Reserve Bulletin, September, 1917, page 690.)

The note of a manufacturer secured by his bills receivable is desirable paper, and should certainly not be debarred as a collateral trust note.

(Ruling, Federal Reserve Bulletin, July, 1915, page 127.)

A note, draft, or bill of exchange drawn for commercial purposes and otherwise eligible for rediscount under the provisions of section 13 of the Federal Reserve Act is not rendered ineligible merely because it is secured by a mortgage on real estate.

(Opinion of Counsel, Federal Reserve Bulletin, June, 1917, page 458.)

Paper secured by staple perishable food products such as butter, cheese, eggs, poultry, frozen fish, etc., carried for seasonable periods in cold storage on negotiable warehouse receipts, is eligible, if offered with the indorsement of a member bank at the usual rate for ninety-day commercial paper.

(Ruling, Federal Reserve Bulletin, January, 1918, page 30.)

A member bank making loans against warehouse receipts for potatoes properly insured could rediscount such paper with its Federal reserve bank for periods not longer than ninety days.

(Ruling, Federal Reserve Bulletin, August, 1917, page 614.)

The note of a furnace company secured by pig iron manufactured by the company on contract for delivery is eligible for rediscount. While this principle generally holds good, each case should be carefully scrutinized that the collateral may be readily marketable goods.

(Ruling, Federal Reserve Bulletin, July, 1915, page 127.)

The Board upholds a Federal reserve bank in declining to give assurance to the receiver of an insolvent member bank that the Federal reserve

*Collateral of bills receivable*

*Collateral of mortgages*

*Notes secured by food products*

*Potatoes as security*

*Pig iron security*

*Rediscount for insolvent bank when reopened*

bank will upon the reopening of the insolvent bank rediscount eligible paper freely, without requiring the indorsement of directors or other additional security. Offerings should be considered upon their merits.

(Ruling, Federal Reserve Bulletin, February, 1916, page 66.)

**Notes Based on United States Obligations.**

Any member bank which has loaned money to any of its customers for the purpose of carrying or trading in bonds or notes of the United States may rediscount with its Federal reserve bank the bill or note of its customer, provided such bill or note

(a) Has a maturity at the time of discount of not more than ninety days, exclusive of days of grace; and

(b) Has the indorsement of the member bank.

Such bill or note, however, need not necessarily be secured and need not be drawn for a commercial purpose other than for the purpose of carrying or trading in notes or bonds of the United States.

(Ruling, Federal Reserve Bulletin, March, 1917, page 158.)

**Conditions of  
eligibility**

**Maturity in relation  
to eligibility**

A member bank acting through another member bank may obtain the discount of its paper secured by Government bonds for a period as long as ninety days, although a member bank acting alone may not tender its collateral note to the Federal reserve bank, which runs for more than fifteen days.

It may be proper in this connection to consider questions of fact; but in case a country bank which has regular dealings with a large bank in a city sends its note secured by Government bonds to that bank, the Board would regard the note as eligible for rediscount by the city bank.

(Ruling, Federal Reserve Bulletin, September, 1918, page 863.)

If the proceeds of a note have been used or are to be used to carry or trade in United States obligations, the note, if acquired in good faith, should be eligible for rediscount with the indorsement of the member bank, whether it is executed by a member or by a nonmember bank.

(Ruling, Federal Reserve Bulletin, August, 1918, page 743.)

Notes of non-member banks

## INELIGIBLE CLASSES OF NOTES

### Statutory Provisions

The Federal Reserve Board . . . . [shall] have security paper the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act . . . . but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States.

(Federal Reserve Act, Section 13.)

### Regulations of Federal Reserve Board

The paper must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for permanent or fixed investments of any kind, such as land, buildings, or machinery, or for any other capital purpose.

Notes for fixed investments

The paper must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for investments of a purely speculative character or for the purpose of lending to some other borrower.

Speculative or finance paper

(Regulation A, Series of 1920, A, II.)

### Opinions and Rulings

Renewals differ, and banking judgment determines the merits of each particular case. Those discount of renewal notes

providing working capital or to finance fixed investments are not eligible for rediscount. Banks should not enter into an agreement for a renewal.

(Ruling, Federal Reserve Bulletin, June, 1915, page 74.)

Interested  
maker or  
indorser

**Finance Paper.**  
A note is not eligible as commercial paper unless made or indorsed by a party to the commercial transaction out of which it arises.

(Federal Reserve Bulletin, September, 1921, page 1079.)

Notes to  
replace  
funds  
withdrawn

A note executed by bank "A," and discounted by bank "B," the proceeds of which were used to replace funds withdrawn by customers to purchase Liberty bonds, is not eligible for rediscount by a Federal reserve bank, since the proceeds were not used for an agricultural, industrial, or commercial purpose, or for the purchase of notes or bonds of the United States.

(Opinion of Counsel, Federal Reserve Bulletin, December, 1917, page 954.)

Paper  
secured by  
war savings  
stamps

Notes, drafts, and bills of exchange which are secured by war savings stamps and the proceeds of which were used to purchase or carry war savings stamps are ineligible for rediscount with a Federal reserve bank.

War savings stamps are in effect receipts for payment on account of nonnegotiable evidences of indebtedness (war savings certificates), and could not be classified as bonds or notes of the United States.

(Opinion of Counsel, Federal Reserve Bulletin, July, 1918, page 687.)

Notes of  
land  
banks

The Federal Reserve Board has heretofore ruled that collateral notes of a Federal land bank secured by farm loan bonds are not eligible for rediscount

by a Federal reserve bank. Joint stock land banks are organized for the purpose of engaging in the business of lending on farm mortgage securities and issuing farm loan bonds. Their business is therefore clearly a finance business, and paper issued by them for the purpose of procuring funds to lend for agricultural uses is necessarily finance paper and not commercial, industrial, or agricultural paper within the meaning of section 13 of the Federal Reserve Act, even though the ultimate borrower may use the proceeds for one of the purposes specified in the law.

(Ruling, Federal Reserve Bulletin, June, 1920, page 609.)

The note of an acceptance house or broker, secured by acceptances eligible for rediscount at a Federal reserve bank, is not eligible for rediscount.

Notes of  
acceptance  
houses or  
brokers

The note of the acceptance house or broker can not be said to have been used for an industrial, agricultural, or commercial purpose, since the business of such acceptance house or broker is not such as to come within any of these classifications. The fact that the note is secured by eligible paper is immaterial if the proceeds are not used for one of the purposes named.

(Ruling, Federal Reserve Bulletin, February, 1918, page 108.)

The note of a finance or credit company which is drawn either directly or indirectly to finance some industrial or commercial concern in the transaction of its business is not eligible for rediscount, even though it may be secured by paper which is itself eligible for rediscount.

Notes of  
finance  
companies

(Ruling, Federal Reserve Bulletin, March, 1918, page 197.)

Collateral  
trust  
notes

The Board holds that collateral trust notes of so-called finance companies should not be accepted by Federal reserve banks for rediscount. Such a transaction is not a commercial one.

(Ruling, Federal Reserve Bulletin, June, 1915, page 72.)

Loans to  
third  
parties

The words "in the first instance" were inserted in Regulation A, Series of 1920, A, II, for the express purpose of making it clear that the making of loans to third parties is a finance rather than a commercial or agricultural purpose, even though it appears that the third parties are to use the funds for commercial or agricultural purposes.

A note of a cotton factor, the proceeds of which are loaned to his customers, is ineligible for rediscount even though the loan is merely incidental to the main business of the factor. The test of eligibility is not the character of the business of the borrower but the use of the proceeds of the particular instrument.

(Ruling, Federal Reserve Bulletin, November, 1920, page 1176.)

Notes  
of cold  
storage  
company

Notes of a cold storage company would be ineligible if the proceeds are to be used by the company to make loans to its customers even though such notes are secured by the eligible notes of the company's customers.

(Ruling, Federal Reserve Bulletin, March, 1921, page 309.)

Collateral  
of bills  
receivable

The note of a manufacturer secured by his bills receivable and issued for the purpose of carrying collateral for a speculative purpose or collateral in the nature of stocks and bonds other than the securities of the United States, would not be eligible for rediscount.

(Ruling, Federal Reserve Bulletin, July, 1915, page 127.)

**Fixed Investments.**

The motor trucks of a corporation furnishing motor transportation constitute permanent or fixed investments. Consequently, the notes of such a corporation issued for the purpose of providing funds to purchase motor trucks are ineligible for rediscount. Motor trucks

A note given by such a corporation to the seller in payment for motor trucks purchased is commercial paper in the hands of the seller and may therefore be eligible for rediscount after it has been discounted by the seller.

(Ruling, Federal Reserve Bulletin, February, 1921, page 191.)

The note of the owner of property which is to be developed or built upon, the proceeds of which note have been or are to be used by him to pay for the work of developing or building, is generally a note "the proceeds of which have been or are to be used for permanent or fixed investment" within the meaning of the Board's regulation, and therefore such a note is not eligible for rediscount. Development of property

(Ruling, Federal Reserve Bulletin, July, 1920, page 699.)

**Nonnegotiable Paper.**

A bill made payable with "collection charges" is not a negotiable instrument, though the Negotiable Instruments Law provides that an instrument payable "with exchange" does not lose its negotiability. Exchange and collection charges distinguished

Counsel suggests that the amount of exchange is usually ascertainable in advance while collection charges are not so ascertainable.

(Opinion of Counsel, Federal Reserve Bulletin, November, 1917, page 880.)

Charges before and after maturity

While a bill containing a provision for payment of the costs of collection and attorney's fees, if it is dishonored at maturity, is a valid negotiable instrument, a bill drawn for a fixed sum "with collection charges" is not a negotiable instrument unless it is so drawn as to show that no collection charges are to be included unless the bill is dishonored at maturity.

(Opinion of Counsel, Federal Reserve Bulletin, August, 1918, page 745.)

Assignment of open accounts ineligible

The assignment of an open account is not negotiable paper and is not eligible for rediscount by a Federal reserve bank under the terms of section 13 of the Federal Reserve Act.

(Opinion of Counsel, Federal Reserve Bulletin, May, 1916, page 227.)

## EVIDENCE OF ELIGIBILITY

### Regulations of Federal Reserve Board

Evidence of eligibility

A Federal reserve bank must be satisfied by reference to the note or otherwise that it is eligible for rediscount. The member bank shall certify in its application whether the note offered for rediscount has been discounted for a depositor other than a bank or for a nondepositor and, if discounted for a bank, whether for a member or a nonmember bank. The member bank must also certify whether a financial statement of the borrower is on file with it.

Statement required

A recent financial statement of the borrower must be on file with the member bank in all cases, except with respect to any note discounted by a member bank for a depositor other than a bank or another member bank if—

(1) It is secured by a warehouse, terminal, or other similar receipt covering goods in storage, or by bonds or notes of the United States; or

(2) The aggregate of obligations of the borrower rediscounted and offered for rediscount at the Federal reserve bank by the member bank is less than a sum equal to ten per cent. of the paid-in capital of the member bank and is less than \$5,000.

The Federal reserve bank shall use its discretion in taking the steps necessary to satisfy itself as to eligibility. Compliance of the note . . . [with the requirement that its proceeds must not have been used or be used for permanent or fixed investments or for any other capital purpose] may be evidenced by a statement of the borrower showing a reasonable excess of quick assets over current liabilities. A Federal reserve bank may, in all cases, require the financial statement of the borrower to be filed with it.

(Regulation A, Series of 1920, A, IV.)

#### Opinions and Rulings

Federal reserve banks are authorized to discount cotton-mill paper indorsed by member banks where general conditions are satisfactory and statement of cotton mill shows that plant is not mortgaged and that the deficiency between capital and plant account does not amount to more than \$5 per spindle.

Cotton-mill  
paper

(Ruling, Federal Reserve Bulletin, June, 1915, page 78.)

It is not the present policy of the Federal Reserve Board to lay down definite tests for determining whether paper which is eligible for discount as a matter of law should be considered acceptable for rediscount from a credit standpoint. The test prescribed in the ruling [published on page 73 of

Ratio of  
quick  
assets to  
current  
liabilities

the Federal Reserve Bulletin for June, 1915] for determining the acceptability of paper of the character referred to should not therefore be regarded as binding on Federal reserve banks.

A Federal reserve bank may, if it so desires, rediscount a note made by a borrower whose statement fails to show an excess of quick assets over current liabilities. Such a statement is not the only evidence by which a Federal reserve bank may satisfy itself that the proceeds of a note have not been used and are not to be used for permanent or fixed investments. It is a question of policy to be determined by the Federal reserve bank in each case whether that bank will rediscount a particular note offered to it in spite of the fact that the borrower's statement fails to show a reasonable excess of quick assets over current liabilities.

(Ruling, Federal Reserve Bulletin, May, 1921, page 546.)

Standing timber

The Board does not regard it as safe policy for Federal reserve banks to treat timber standing upon tracts of land as quick assets, similar to manufactured goods in the hands of the manufacturer or jobber.

(Ruling, Federal Reserve Bulletin, July, 1915, page 126.)

Unmined minerals

Unmined minerals are not regarded as quick assets.

(Ruling, Federal Reserve Bulletin, July, 1915, page 126.)

## MATURITY

### Statutory Provisions

Commercial paper

Notes, drafts, and bills admitted to discount under the terms of this paragraph must have a maturity at the time of discount of not more than ninety days, exclusive of days of grace: *Provided*, That notes, drafts, and bills drawn or issued for agri-

cultural purposes or based on live stock and having a maturity not exceeding six months, exclusive of days of grace, may be discounted in an amount to be limited to a percentage of the assets of the Federal reserve bank, to be ascertained and fixed by the Federal Reserve Board.

Agricultural  
or live stock  
paper

(Federal Reserve Act, Section 13.)

### Opinions and Rulings

A bill payable "on or before" a certain date is negotiable paper and, if otherwise in conformity with the provisions of law and of the Federal Reserve Act, is eligible for discount by a Federal reserve bank.

Notes payable  
"on or before"

(Ruling, Federal Reserve Bulletin, August, 1916, page 394.)

A demand note or bill is not eligible under the provisions of the Act, since it is not in terms payable within the prescribed ninety days, but may, at the option of the holder, not be presented for payment until after that time.

Demand notes

If the bill were altered so as to read "on or before \_\_\_\_\_ days from date, pay to the order of ourselves," etc., it would come within the terms of the law and would be eligible for rediscount.

(Ruling, Federal Reserve Bulletin, May, 1917, page 378.)

A note made payable "on demand, and if no demand is made, then on \_\_\_\_\_," is eligible for rediscount by a Federal reserve bank, provided that the date to be filled in is not more than ninety days from the date of discount, and provided further it conforms to the other provisions of law and the regulations of the Board.

Note payable before  
certain date

(Ruling, Federal Reserve Bulletin, July, 1917, page 527.)

Extension of time

A note or draft containing a provision for an extension of time should not be approved for general use by the Federal Reserve Board.

(Opinion of Counsel, Federal Reserve Bulletin, September, 1918, page 870.)

Alteration of maturity provision

In the opinion of this office the holder of a note which contains a provision for its extension from time to time without notice has no right to strike out this provision or to effect any alteration in a negotiable note after it has been discounted, and to do so might have the effect of releasing some of the parties to the note.

(Ruling, Federal Reserve Bulletin, November, 1918, page 1118.)

Direct loans and rediscounts distinguished

A member bank acting through another member bank may obtain the discount of its paper secured by Government bonds for a period as long as ninety days, although a member bank acting alone may not tender its collateral note to the Federal reserve bank, which runs for more than fifteen days.

It may be proper in this connection to consider questions of fact—whether the transaction is in good faith or whether the two banks exchange courtesies merely for the purpose of having their notes discounted for ninety days instead of fifteen days; but in case a country bank which has regular dealings with a large bank in a city sends its note secured by Government bonds to that bank, the Board would regard the note as eligible for rediscount by the city bank.

(Ruling, Federal Reserve Bulletin, September, 1918, page 863.)

## AMOUNT OF PAPER OF ONE INTEREST REDISCOUNTABLE FOR ONE MEMBER BANK

### Statutory Provisions

The aggregate of such notes, drafts, and bills bearing the signature or indorsement of any one borrower, whether a person, company, firm, or corporation, rediscounted for any one bank shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank; but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values.

Ten per cent.  
limit

Exception

(Federal Reserve Act, Section 13.)

No Federal reserve bank shall be permitted to discount for any [member] State bank or trust company notes, drafts, or bills of exchange of any one borrower who is liable for borrowed money to such State bank or trust company in an amount greater than ten per centum of the capital and surplus of such State bank or trust company, but the discount of bills of exchange drawn against actually existing value and the discount of commercial or business paper actually owned by the person negotiating the same shall not be considered as borrowed money within the meaning of this section. The Federal reserve bank, as a condition of the discount of notes, drafts, and bills of exchange for such State bank or trust company, shall require a certificate or guaranty to the effect that the borrower is not liable to such bank in excess of the amount provided by this section, and will not be permitted to become liable in excess of this amount while such notes, drafts, or bills of exchange are under discount with the Federal reserve bank.

Rediscounts  
for member  
State banks

Conditions

(Federal Reserve Act, Section 9.)

Rediscount  
of war paper  
until October  
31, 1921

Upon the affirmative vote of not less than five of its members, the Federal Reserve Board shall have power to permit Federal reserve banks to discount for any member bank notes, drafts, or bills of exchange bearing the signature or endorsement of any one borrower in excess of the amount permitted by section 9 and section 18 of this Act, but in no case to exceed twenty per centum of the member bank's capital and surplus: *Provided, however,* That all such notes, drafts, or bills of exchange discounted for any member bank in excess of the amount permitted under such sections shall be secured by not less than a like face amount of bonds or notes of the United States issued since April 24, 1917, for which the borrower shall in good faith prior to January 1, 1921, have paid or agreed to pay not less than the full face amount thereof, or certificates of indebtedness of the United States: *Provided, further,* That the provisions of this subsection (m) shall not be operative after October 31, 1921.

(Federal Reserve Act, Section 11 (m).)

#### Regulations of Federal Reserve Board

Rediscount  
of war paper  
for members

Under the terms of section 11 (m) as amended by the Act of February 27, 1921, a Federal reserve bank may, until October 31, 1921, rediscount for any member bank, whether State or National, notes, drafts, and bills bearing the signature or indorsement of any one borrower in an amount not to exceed twenty per cent. of the member bank's capital and surplus, provided that the excess over and above ten per cent. be secured by not less than a like face amount of bonds or notes of the United States issued since April 24, 1917, for which the borrower shall in good faith prior to January 1, 1921, have

paid or agreed to pay not less than the full face amount thereof, or certificates of indebtedness of the United States.

(Regulation A, Series of 1920, A, I, Note, as amended in effect by Act of February 27, 1921.)

Under the terms of section 11 (m) as amended by the Act of February 27, 1921, a Federal reserve bank may, until October 31, 1921, rediscount for a member State bank or trust company paper of any one borrower secured by not less than a like face amount of bonds or notes of the United States issued since April 24, 1917, for which the borrower shall in good faith prior to January 1, 1921, have paid or agreed to pay not less than the full face amount thereof, or certificates of indebtedness of the United States, even though such State bank or trust company may already have loaned to the borrower under his regular line of credit in excess of the ten per cent. limit defined above. If, however, the member State bank or trust company has loaned to one borrower in excess of that ten per cent. limit under his regular line of credit, the Federal reserve bank can not rediscount for that State bank or trust company any of the paper of that borrower taken under that regular line of credit, but may rediscount any paper so secured by Government obligations of the kinds specified, acquired under the conditions set forth above, up to an amount not in excess of twenty per cent. of the capital and surplus of such State bank or trust company.

(Regulation A, Series of 1920, A, I, Note, as amended in effect by Act of February 27, 1921.)

#### Opinions and Rulings

If any particular paper presented by a member bank to a Federal reserve bank for rediscount, Paper of one  
maker or  
indorser

singly or added to the paper of the same makers or indorsers which the Federal reserve bank has already discounted for said member bank, amounts to a total of more than ten per cent. of the unimpaired capital and surplus of that bank, the Federal reserve bank has no authority for such rediscount.

(Ruling, Federal Reserve Bulletin, May, 1916, page 224.)

**Discretion  
of reserve  
bank**

A Federal reserve bank may properly decline to discount for a member bank the paper of any one borrower on the ground that the Federal reserve bank has theretofore discounted for other member banks what it deems to be a sufficient amount of that particular borrower's paper.

(Ruling, Federal Reserve Bulletin, March, 1920, page 276.)

**Not applicable  
to rediscounting  
bank**

In the opinion of the Board the limitations contained in section 13 of the Federal Reserve Act on the rediscount of paper bearing the signature or indorsement of any one borrower should not be held to refer to the indorsement of a nonmember bank on paper rediscounted with a member bank.

(Ruling, Federal Reserve Bulletin, June, 1918, page 520.)

**Paper of  
cotton  
broker**

A cotton broker who is a depositor of a bank finances cotton for various mills by giving to the bank his note secured by warehouse receipts of the mills indorsed in blank, for cotton stored in his name and properly insured, but sold to the mill for a specific amount to be paid at a specific time, as per sales note attached. The question arises whether such loans taken from one broker in excess of ten per cent. of the capital and surplus of the bank would be an excess loan under the Federal Reserve Act, if the financing for each individual mill and the accepted sales note held of said mill were not in excess of said ten per cent.

It is held that the transaction in form is merely a discount of single name negotiable paper secured by so many bales of cotton. No Federal reserve bank could rediscount such notes bearing the name of one broker for an aggregate amount in excess of ten per cent. of the capital and surplus of the member bank.

(Ruling, Federal Reserve Bulletin, March, 1916, page 113.)

While a member bank may acquire commercial or business paper from the same person in excess of ten per cent. of its unimpaired capital and surplus, its Federal reserve bank can not rediscount such paper bearing the signature or indorsement of the same person in excess of that amount.

Commercial  
or business  
paper

Section 13, Federal Reserve Act, does not amend section 5200, United States Revised Statutes.\*

(Opinion of Counsel, Federal Reserve Bulletin, June, 1916, page 274.)

A note or bill rediscounted in good faith by a member bank, which is no longer owned or held by the bank, need not be included as a liability of the maker to the bank within the meaning of section 5200, Revised Statutes. Notes or bills rediscounted under an agreement to repurchase, or which are merely credited to the account of the bank offering them for rediscount, are subject to the limitations of section 5200.

Rediscounted paper  
not limited by  
section 5200

(Opinion of Counsel, Federal Reserve Bulletin, September, 1918, page 867.)

#### Rediscounts for Member State Banks.

The provisions of section 9 of the Federal Reserve Act limiting the amount of paper of any one borrower which may be rediscounted for a State

Total  
capital  
and  
surplus

\*For section 5200 see page 64, above.

member bank to ten per cent. of the capital and surplus of that bank relate to the total capital and surplus of the bank and not merely to the capital and surplus assigned under the terms of the State law to the commercial department of the bank.

(Opinion of Counsel, Federal Reserve Bulletin, May, 1920, page 495.)

Limitations of  
sections 9 and  
13 distinguished

Under the terms of section 13 no Federal reserve bank may properly rediscount for any State member bank the paper of any one borrower in excess of ten per cent. of the capital and surplus of that member bank. Bills of exchange which are drawn against actually existing values are expressly excepted from this limitation but commercial or business paper must be included within it.

Section 9 provides that no Federal reserve bank may discount for any State member bank any of the paper of any one borrower who is liable to such bank for borrowed money in excess of ten per cent. of the capital and surplus of the State bank. In determining whether a customer is liable to a State bank in an amount in excess of ten per cent., neither bills of exchange drawn against actually existing values nor commercial or business paper actually owned by the person negotiating it shall be considered, but this provision cannot in any way be construed to authorize the Federal reserve bank to rediscount for a State member bank in excess of the limits prescribed by section 13.

(Opinion of Counsel, Federal Reserve Bulletin, December, 1919, page 1157.)

Rediscounted  
paper not  
limited

Where a State bank, which is a member of the Federal Reserve System, has loaned to one of its customers an amount equal to thirty per cent. of its capital and surplus, and has rediscounted two-

thirds of this amount with a correspondent bank, the remaining one-third is eligible for rediscount with its Federal reserve bank.

(Opinion of Counsel, Federal Reserve Bulletin, July, 1918, page 638.)

### AGGREGATE AMOUNT REDISCOUNTABLE FOR ONE BANK

#### Statutory Provisions

No national banking association shall at any time be indebted, or in any way liable, to an amount exceeding the amount of its capital stock at such time actually paid in and remaining undiminished by losses or otherwise, except on account of . . . liabilities incurred under the provisions of the Federal Reserve Act.

Not limited  
by section 5202

(Section 5202, Revised Statutes, as amended.)

The discount and rediscount and the purchase and sale by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board.

Subject to  
regulations  
of Federal  
Reserve Board

(Federal Reserve Act, Section 18.)

Said board [of directors of each Federal reserve bank] shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks and shall, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks.

Duty of  
Federal  
reserve  
bank  
directors

(Federal Reserve Act, Section 4.)

### Opinions and Rulings

Not limited  
by law

The law places no limitation upon the amount of commercial paper which a member bank may rediscount with a Federal reserve bank, but leaves this to the judgment of the officers of the Federal reserve bank.

(Ruling, Federal Reserve Bulletin, September, 1916, page 457.)

## INDORSEMENT OF MEMBER BANKS

### Statutory Provisions

Indorsement

Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice and protest by such bank as to its own indorsement exclusively, any Federal reserve bank may discount notes, drafts, and bills of exchange.

(Federal Reserve Act, Section 13.)

### Opinions and Rulings

Indorsement  
is waiver

A simple written indorsement will be regarded as satisfactory and as coming within the terms of the law.

(Ruling, Federal Reserve Bulletin, October, 1916, page 524.)

Without  
recourse

If a note is otherwise eligible for rediscount, the fact that it bears a "without recourse" indorsement of a nonmember bank will not affect its eligibility.

(Opinion of Counsel, Federal Reserve Bulletin, August, 1918, page 745.)

## REDISCOUNT FOR NONMEMBER BANKS

### Statutory Provisions

Procuring rediscounts  
for nonmembers

No member bank shall act as the medium or agent of a nonmember bank in applying for or receiving discounts from a Federal reserve bank un-

der the provisions of this Act, except by permission of the Federal Reserve Board.

(Federal Reserve Act, Section 19.)

### Opinions and Rulings

Assuming that the paper offered by a member bank for rediscount is eligible under the regulations prescribed by the Board, it would be necessary in each case for the officers of the Federal reserve bank to determine whether or not the proceeds of such discount are to be used for the purpose of making a loan to a nonmember bank. If the money thus borrowed is to be re-lent to a nonmember bank, rediscount should not be accepted without the permission of the Federal Reserve Board. If, on the other hand, a member bank had in good faith acquired from a nonmember bank by rediscount notes which are eligible under the regulations of the Board for rediscount with the Federal reserve bank, and such notes were held as a part of the assets of the member bank, there would seem to be no objection to the Federal reserve bank's accepting such rediscounts, provided the officers are satisfied that the transaction is a bona fide transaction and that the member bank did not extend accommodation to the nonmember bank with a view to rediscounting notes so acquired with the Federal reserve bank.

Paper  
acquired from  
nonmembers

This is one of the cases which must be left very largely to the judgment and discretion of the Federal reserve bank officers; and a determination must be reached by them on the facts of the case.

(Ruling, Federal Reserve Bulletin, August, 1915, page 213.)

The Federal Reserve Board has given general authority to member banks to apply to their respec-

Application  
to discount

tive Federal reserve banks for discounts of eligible paper acquired by such member banks from non-member banks, such authority to be effective until withdrawn by the Federal Reserve Board. The extent to which the respective Federal reserve banks will entertain such application is, of course, a matter of policy for the determination of the officers of each bank.

(Ruling, Federal Reserve Bulletin, August, 1921, page 968.)

Paper  
indorsed by  
nonmembers

In the opinion of the Board the limitations contained in section 13 of the Federal Reserve Act on the rediscount of paper bearing the signature or indorsement of any one borrower should not be held to refer to the indorsement of a nonmember bank on paper rediscounted with a member bank.

It is true that in such case the nonmember bank is contingently liable if the paper is not paid at maturity, but the Board is inclined to the view that this language refers to paper bearing the signature or indorsement of borrowers or customers of the member bank and not to the indorsement of other banks. A nonmember bank could not, of course, obtain indirect accommodation from the Federal reserve bank through the medium or agency of a member bank except with the permission of the Federal Reserve Board, but if a member bank had acquired eligible paper in due course by rediscount from a nonmember bank the member bank should hardly be precluded from rediscounting this paper with the Federal reserve bank because it bears the indorsement of the nonmember bank.

(Ruling, Federal Reserve Bulletin, June, 1918, page 520.)

## **Rediscount of Drafts and Trade Acceptances**

### **DEFINITION OF DRAFT OR BILL OF EXCHANGE**

#### **Regulations of Federal Reserve Board**

A draft or bill of exchange, within the meaning of this regulation, is defined as an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay in the United States, at a fixed or determinable future time, a sum certain in dollars to the order of a specified person.

*Draft or bill  
of exchange*

(Regulation A, Series of 1920, A, V.)

#### **Opinions and Rulings**

A note or draft containing a provision for an extension of time should not be approved for general use by the Federal Reserve Board.

*Extension  
of time*

(Opinion of Counsel, Federal Reserve Bulletin, September, 1918, page 870.)

The drawer and indorser of a bill of exchange made payable on a date specified in the bill are not discharged by a failure to present for acceptance, unless the bill expressly provides that it must be presented for that purpose, or unless it is payable elsewhere than at the residence or place of business of the drawee.

*Presentment  
of bills for  
acceptance*

(Opinion of Counsel, Federal Reserve Bulletin, November, 1916, page 608.)

The acceptor of a bill of exchange is the principal debtor. The law requires that notice of demand and protest be given to parties secondarily

*Acceptor not  
affected by  
waiver*

No. _____	(DATE OF MATURITY)	192	
		(CITY OF DRAWER)	(DATE)
<b>PAY TO THE ORDER OF OURSELVES</b>			
		DOLLARS (\$ _____)	
		(SIGNATURE OF DRAWER)	
		BY _____	
		LOCATION OF BANK	
		(NAME OF BANK)	
		PAYABLE AT	
		DATE	
		(STREET ADDRESS)	
		(CITY OF DRAWEE)	
<b>ACCEPTED</b>			
THE OBLIGATION OF THE ACCEPTOR HEREOF ARISES OUT OF THE PURCHASE OF GOODS FROM THE DRAWER. THE DRAWEE MAY ACCEPT THIS BILL PAYABLE AT ANY BANK, BANKER OR TRUST COMPANY IN THE UNITED STATES WHICH SUCH DRAWEE MAY DESIGNATE.			
TO _____			
BY _____			
(SIGNATURE OF DRAWER)			

**TRADE ACCEPTANCE**

SPECIMEN OF TRADE ACCEPTANCE

liable in case of dishonor. This right to receive notice is a personal one which may be waived by the parties entitled thereto, that is, the drawer and indorser; but such waiver has no effect on the acceptor or principal debtor.

(Opinion of Counsel, Federal Reserve Bulletin, September, 1915, page 277.)

A sight draft which is accepted by the drawee, payable at a future date, is a qualified acceptance which the holder may refuse to take, but if such an acceptance is taken by the holder, the drawer and indorsers are released unless they have either expressly or impliedly authorized the holder to take a qualified acceptance or unless they subsequently assent thereto.

(Opinion of Counsel, Federal Reserve Bulletin, June, 1919, page 566.)

#### Negotiability.

The negotiability of a bill of exchange is not affected by provisions which waive demand, notice, and protest; which waive homestead exemption rights; and which provide for the costs of collection and attorney's fees.

Effect of waivers

(Opinion of Counsel, Federal Reserve Bulletin, May, 1916, page 226.)

A provision in a draft or bill of exchange that it is payable "with interest at the rate of — per cent. per annum after maturity, if payment is delayed," does not affect the negotiability of the instrument.

Drafts payable with interest

(Opinion of Counsel, Federal Reserve Bulletin, March, 1917, page 200.)

A draft made "payable on arrival of car" is non-negotiable, not being payable at a determinable future time.

Drafts payable on condition

(Opinion of Counsel, Federal Reserve Bulletin, August, 1915, page 219.)

Exchange and  
collection  
charges

A bill made payable with "collection charges" is not a negotiable instrument, though the Negotiable Instruments Law provides that an instrument payable "with exchange" does not lose its negotiability.

Counsel suggests that the amount of exchange is usually ascertainable in advance while collection charges are not so ascertainable.

(Opinion of Counsel, Federal Reserve Bulletin, November, 1917, page 880.)

Charges before  
and after maturity

While a bill containing a provision for payment of the costs of collection and attorney's fees, if it is dishonored at maturity, is a valid negotiable instrument, a bill drawn for a fixed sum "with collection charges" is not a negotiable instrument unless it is so drawn as to show that no collection charges are to be included unless the bill is dishonored at maturity.

(Opinion of Counsel, Federal Reserve Bulletin, August, 1918, page 745.)

Drafts payable  
to order of  
drawee

A bill made payable to the order of the drawee is not negotiable until the drawee as payee has indorsed it. When it has been accepted and indorsed by the drawee it is a valid negotiable instrument in the hands of a third party, and the drawer is not released, since the terms of his order have been specifically complied with.

(Opinion of Counsel, Federal Reserve Bulletin, February, 1918, page 110.)

Acceptance  
without  
drawer's  
signature

Under the terms of the negotiable instruments law a bill of exchange may be accepted before it has been signed by the drawer.

(Opinion of Counsel, Federal Reserve Bulletin, December, 1919, page 1157.)

Inspection  
of goods

An express provision in a bill of lading authorizing the consignee to inspect the goods before ac-

ceptance of the draft to which the bill of lading is attached does not affect the negotiability of the draft.

(Ruling, Federal Reserve Bulletin, May, 1919, page 468.)

### DEFINITION OF TRADE ACCEPTANCE

#### Regulations of Federal Reserve Board

A trade acceptance is defined as a draft or bill of exchange, drawn by the seller on the purchaser of goods sold,\* and accepted by such purchaser.

(Regulation A, Series of 1920, A, V.)

#### Opinions and Rulings

A draft to be eligible as a trade acceptance must be accepted by the drawee and not by anyone else.

(Ruling, Federal Reserve Bulletin, March, 1916, page 112.)

A trade acceptance containing the statement that "the obligation of the acceptor hereof arises out of the purchase of goods from the drawer as per invoices, a record of which is given in the subjoined statement," is a valid and desirable acceptance when offered with the "subjoined statement" detached in accordance with directions in the form.

An acceptance to pay at a particular place different from the residence of the acceptor is a general acceptance, unless it expressly states that the bill is to be paid there and not elsewhere, and does not render the bill nonnegotiable.

(Ruling, Federal Reserve Bulletin, February, 1919, page 142.)

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\*A consignment of goods or a conditional sale of goods can not be considered "goods sold" within the meaning of this clause. The purchase price of goods plus the cost of labor in effecting their installation may be included in the amount for which the trade acceptance is drawn.

## Discount for payment at maturity

A trade acceptance which consists of an order to pay a certain amount, which is the amount of the debt minus a discount for prompt payment at maturity, or, if not paid at maturity, to pay a greater amount, which is the amount of the debt without any discount, is an order to pay a sum certain and is negotiable.

(Opinion of Counsel, Federal Reserve Bulletin, March, 1918, page 200.)

## Discount for prepayment

A trade acceptance providing for a fixed discount, if paid at a certain time before maturity, should not be approved for general use by the Federal Reserve Board.

(Opinion of Counsel, Federal Reserve Bulletin, September, 1918, page 871.)

## Acceptance based on foreign shipments

On the basis of the facts submitted in this case, it is held that a ninety-day sight draft drawn by a firm in Calcutta on a company in Boston and accepted by that firm, covering a transaction involving the transportation of merchandise from Calcutta to Honolulu, is a trade acceptance rather than a banker's acceptance.

(Ruling, Federal Reserve Bulletin, December, 1915, page 404.)

The fact that importation or exportation is involved does not exclude the character of a trade acceptance.

(Ruling, Federal Reserve Bulletin, April, 1916, page 168.)

## Acceptances based on future purchases

A bill, in order to be a trade acceptance, must arise out of the purchase of goods, and unless that purchase is either consummated or actually contracted for at the time the bill is drawn, it is doubtful whether it can properly be said that the obligation arises out of the purchase of goods.

(Ruling, Federal Reserve Bulletin, March, 1917, page 378.)

A draft drawn by a casualty company against a policy holder for premiums could hardly be said to be a draft by the seller on the purchaser of goods sold and would not, in the opinion of the Board, come within the Board's present definition of a trade acceptance.

(Ruling, Federal Reserve Bulletin, April, 1918, page 309.)

An acceptance which provides that the drawer is to retain title to the goods until payment of the acceptance is not consistent with the requirement of a legitimate trade acceptance that the title shall have passed to the drawee at the time of acceptance. The actual sale of goods and not what is generally termed a conditional sale of goods must be the basis of the acceptance.

(Ruling, Federal Reserve Bulletin, October, 1919, page 964.)

## ELIGIBLE DRAFTS AND TRADE ACCEPTANCES

### Statutory Provisions

Any Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act. Nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchan-

Drafts in payment of insurance premiums

Conditional sales as basis

Commercial paper

Agricultural paper

Paper based on  
United States  
obligations

dise from being eligible for such discount; [or] . . . notes, drafts, or bills . . . issued or drawn for the purpose of carrying or trading in . . . bonds and notes of the Government of the United States.

(Federal Reserve Act, Section 13.)

Paper secured by  
bonds of  
War Finance  
Corporation

The Federal reserve banks shall be authorized . . . to rediscount eligible paper secured by . . . bonds [of the War Finance Corporation] and indorsed by a member bank. No discount or rediscount under this section shall be granted at a less interest charge than one per centum per annum above the prevailing rates for eligible commercial paper of corresponding maturity.

(War Finance Corporation Act, Section 13.)

#### Regulations of Federal Reserve Board

Conditions of  
eligibility

The Federal Reserve Board, exercising its statutory right to define the character of a note, draft, or bill of exchange eligible for rediscount at a Federal reserve bank, has determined that—

Commercial  
origin

It must be a note, draft, or bill of exchange which has been issued or drawn, or the proceeds of which have been used or are to be used in the first instance, in producing, purchasing, carrying, or marketing goods\* in one or more of the steps of the process of production, manufacture, or distribution, or for the purpose of carrying or trading in bonds or notes of the United States.

Security

It may be secured by the pledge of goods or collateral of any nature, including paper, which is

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\*When used in this regulation the word "goods" shall be construed to include goods, wares, merchandise, or agricultural products, including live stock.

ineligible for rediscount, provided it (the note, draft, or bill of exchange) is otherwise eligible.

(Regulation A, Series of 1920, A, II.)

### Opinions and Rulings

Bills drawn for the purpose of providing funds for the purchase and export of cross-ties and lumber to Cuba are eligible for rediscount if properly indorsed and otherwise conforming to the regulations of the Federal Reserve Board.

(Ruling, Federal Reserve Bulletin, September, 1915, page 268.)

Where a railroad company purchasing supplies accepts the draft of the seller and the seller or a third party to whom the draft is sold in good faith discounts it with a member bank, such draft is eligible for rediscount with a Federal reserve bank.

(Opinion of Counsel, Federal Reserve Bulletin, October, 1918, page 974.)

An acceptance drawn by a gas producing company on a gas distributing company and accepted by the latter in payment for gas sold and delivered is a trade acceptance, eligible for rediscount by a Federal reserve bank.

(Ruling, Federal Reserve Bulletin, May, 1918, page 435.)

A draft drawn by a lumber corporation upon a sales corporation which it and a number of other lumber concerns have organized will, when accepted, become a trade acceptance, even though the selling corporation is a stockholder of the sales corporation, provided the latter is organized in good faith and not merely to act as an agent for the purpose of evading the law.

(Opinion of Counsel, Federal Reserve Bulletin, January, 1918, page 38.)

Acceptance  
before de-  
livery on  
installment  
plan sales

Regarding the use of trade acceptances in connection with the sale of coffee mills, etc., on an installment plan, if the purchaser is willing to accept a draft in advance of the delivery of the goods there would seem to be no reason why such an acceptance should not be treated on the same basis as a bill drawn and accepted after delivery of such goods.

(Ruling, Federal Reserve Bulletin, May, 1918, page 487.)

Based on  
building  
operations

It is impossible to promulgate any general ruling. There does not seem to be any doubt that a draft drawn by a manufacturer or material man upon a builder to cover the cost of materials sold to the builder is eligible for rediscount as a trade acceptance when accepted by the builder. It is equally clear, however, that if the contractor, for instance, does not get title either to the materials furnished or to the building as it is being erected, he can not properly make a trade acceptance of a draft drawn upon him by the subcontractor or builder, it being apparent that he has not been the purchaser of goods sold within the meaning of the Board's regulations. The Board is not inclined to extend the scope of its definition of the word "goods" to include labor alone.

(Ruling, Federal Reserve Bulletin, June, 1919, page 565.)

Based on  
electrical  
installation

Drafts drawn for the purchase price of electrical goods, including the cost of installation, may be treated as trade acceptances when such drafts are accepted by the purchaser.

(Ruling, Federal Reserve Bulletin, April, 1918, page 310.)

Based on  
retail  
transactions

A bill of exchange drawn by the seller of goods and accepted by the purchaser of those goods is a trade acceptance, regardless of whether or not the

purchaser intends to resell the goods or to use them for his own purpose. Therefore, a retail dealer may finance the sale of his goods to a retail customer by means of the trade acceptance.

A bill drawn by a retail dealer on his retail customer to finance the sale of goods to that customer is a trade acceptance within the meaning of the Board's regulations, even though it is drawn after the purchaser has failed to remit promptly on an open account.

The Board is of the opinion, however, that the attempt to use a trade acceptance in this manner as a means of liquidating an otherwise slow account would involve considerable danger to the primary purposes of the trade acceptance movement and would subordinate the trade acceptance to the open account by suggesting it as a last resort for bad debts.

While, therefore, trade acceptances of this character should probably be considered eligible as a matter of law, nevertheless member banks and Federal reserve banks should be encouraged to discriminate against them as far as possible.

(Ruling, Federal Reserve Bulletin, January, 1918, page 30.)

Drafts of cotton producers or owners drawn upon and accepted by cotton factors may be eligible for rediscount when discounted by the drawers.

(Ruling, Federal Reserve Bulletin, November, 1920, page 1177.)

The Federal Reserve Board may properly rule that a draft or bill of exchange drawn by the seller on the purchaser of advertising space and accepted by such purchaser is a trade acceptance.

(Opinion of Counsel, Federal Reserve Bulletin, February, 1917, page 116.)

Acceptances in  
liquidation  
of open  
accounts

Acceptances of  
cotton factors

Acceptances based on  
advertising space

**Conditions**

A draft or bill of exchange drawn by a publisher or other advertising agency on the purchaser of advertising space, and accepted by such purchaser, shall be considered a trade acceptance, provided the advertisement on which the draft or bill is based is for the purpose of promoting or facilitating the production, manufacture, distribution, or sale of goods, wares, merchandise, or agricultural products, including live stock, and provided, further, that such advertisement is not illegal and is not for the purpose of promoting or facilitating any transaction which is prohibited by the laws of the state in which it is to be consummated.

(Ruling, Federal Reserve Bulletin, February, 1917, page 114.)

**Domicile bills**

Although a draft drawn by an American exporter upon a foreign buyer and accepted by that buyer payable in the United States in dollars may be technically eligible for discount under the terms of section 18 of the Federal Reserve Act, nevertheless, a Federal reserve bank may, in its discretion, decline to discount such an acceptance on the ground that inasmuch as it is a domicile bill, it is not a desirable investment.

(Opinion of Counsel, Federal Reserve Bulletin, April, 1920, page 386.)

## **INELIGIBLE DRAFTS AND TRADE ACCEPTANCES**

### **Statutory Provisions**

**Security paper**

The Federal Reserve Board . . . [shall] have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act . . . but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or

trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States.

(Federal Reserve Act, Section 18.)

### Regulations of Federal Reserve Board

The paper must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for permanent or fixed investments of any kind, such as land, buildings, or machinery, or for any other capital purpose.

The paper must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for investments of a purely speculative character or for the purpose of lending to some other borrower.

(Regulation A, Series of 1920, A, II.)

### Opinions and Rulings

The Board's conception of the trade acceptance is that it is an instrument which carries upon its face the evidence of the commercial character of the transaction which gave it birth. The finance paper of the \_\_\_\_\_ Corporation issued against drafts drawn by it on dealers and placed in trust to secure such paper issued by it in the shape of notes or certificates gives no indication whatever as to the nature of the security, which may or may not be eligible paper.

It appears to the Board that the \_\_\_\_\_ Corporation by issuing notes of this character is really raising money for capital requirements for similar transactions in the future, and that the whole plan is in essence a finance operation rather than a commercial transaction.

(Ruling, Federal Reserve Bulletin, February, 1918, page 109.)

Notes for  
fixed  
investments

Speculative  
or finance  
paper

Drafts to finance  
capital re-  
quirements

Drafts  
against  
wine in  
bend

The Board is of the opinion that a warehouse receipt covering wine in bond, whether intended for sacramental or other purposes, can not be considered a receipt conveying or securing title to "readily marketable staples" within the meaning of section 13 of the Federal Reserve Act, and consequently that drafts secured by warehouse receipts covering such wine are not eligible for rediscount by Federal reserve banks.

(Ruling, Federal Reserve Bulletin, April, 1921, page 419.)

Drafts to  
finance  
war savings  
stamps

Notes, drafts, and bills of exchange which are secured by war savings stamps and the proceeds of which were used to purchase or carry war savings stamps are ineligible for rediscount with a Federal reserve bank.

(Opinion of Counsel, Federal Reserve Bulletin, July, 1918, page 637.)

## EVIDENCE OF ELIGIBILITY

### Regulations of Federal Reserve Board

Financial  
statements

A Federal reserve bank shall take such steps as it deems necessary to satisfy itself as to the eligibility of the draft, bill, or trade acceptance offered for rediscount and may require a recent financial statement of one or more parties to the instrument. The draft, bill, or trade acceptance should be drawn so as to evidence the character of the underlying transaction, but if it is not so drawn evidence of eligibility may consist of a stamp or certificate affixed by the acceptor or drawer in a form satisfactory to the Federal reserve bank.

(Regulation A, Series of 1920, A, V.)

Character  
of evidence

### Opinions and Rulings

Stamp  
is not  
conclusive

The fact that a land company has stamped a bill a trade acceptance and has signed such state-

ment as "acceptor" does not in itself make it a trade acceptance.

(Ruling, Federal Reserve Bulletin, March, 1916, page 112.)

## MATURITY

### Opinions and Rulings

A draft made "payable on arrival of car" is non-negotiable, not being payable at a determinable future time, and is therefore ineligible for rediscount by a Federal reserve bank.

Drafts payable on condition

(Opinion of Counsel, Federal Reserve Bulletin, August, 1915, page 219.)

Drafts payable "ninety days from date or before on five days after demand (i. e., on five days' notice) by the holder hereof" are negotiable and eligible for discount with a Federal reserve bank.

Drafts payable "on or before" certain date

(Opinion of Counsel, Federal Reserve Bulletin, April, 1917, page 291.)

See also "Rediscount of Promissory Notes," pages 94-96, above.

## AMOUNT OF PAPER OF ONE INTEREST REDISCOUNTABLE FOR ONE MEMBER BANK

### Opinions and Rulings

#### What Constitutes "Actually Existing Values."

A trade acceptance may or may not be classified as a bill of exchange drawn against actually existing values.

Trade acceptances

Section 13 of the Federal Reserve Act limits the amount of paper of any one borrower rediscounted for any one bank to ten per cent. of such bank's capital and surplus; and trade acceptances are subject to this limitation, unless they can be classified as "bills of exchange drawn against actually existing values."

Ten per cent. limit

Acceptance  
before sale  
or delivery

Bills drawn by the seller against the purchaser and accepted before the sale or delivery of the goods should not be treated as bills drawn against actually existing values, since such goods are not in the possession of the drawee either in the original form or in the shape of the proceeds of their sale; except where the goods have passed out of the possession of the drawer and have been placed in storage subject to the control or order of the drawee.

(Opinion of Counsel, Federal Reserve Bulletin, October, 1918, page 974.)

Drafts  
discounted  
before  
acceptance

A bill of exchange discounted before acceptance may be said to be drawn against actually existing values, within the meaning of section 13 of the Federal Reserve Act, when and only when it is accompanied by shipping documents, warehouse receipts, or other papers securing title to the goods sold.

Acceptances  
without  
documents

An accepted bill of exchange, unaccompanied by shipping documents or other such papers, may be considered as drawn against actually existing values if drawn against the drawee at the time of, or within a reasonable time after, the shipment or delivery of the goods sold. In this latter case there must be reasonable grounds to believe that the goods are in existence in the hands of the drawee either in their original form or in the shape of the proceeds of their sale.

(Opinion of Counsel, Federal Reserve Bulletin, March, 1917, page 195.)

Trade acceptances  
for long standing  
open accounts

A bill drawn for a balance due on open account of long standing, which is accepted by the debtor, might constitute a trade acceptance, but in order for it to be excepted from the limitations imposed by section 13 of the Federal Reserve Act as a bill of

exchange drawn against actually existing value, it must have been drawn contemporaneously with, or within such a reasonable time after, the shipment of the goods as to justify the assumption that the goods are in the hands of the drawee in their original form or in the form of proceeds of sale.

As evidence of this fact, Federal reserve banks might reasonably require such trade acceptances as are offered as "bills of exchange drawn against actually existing value" to show the date of invoice, so that it may be determined whether or not the account is one of long standing.

(Ruling, Federal Reserve Bulletin, April, 1917, page 287.)

A bill of exchange drawn payable "at sight" and accepted payable in three months is a qualified or conditional acceptance, and the maker and prior indorsers are released. The instrument in effect becomes the promissory note of the acceptor, and would not come within the exception to section 13 of a bill of exchange drawn in good faith against actually existing value.

(Opinion of Counsel, Federal Reserve Bulletin, September, 1916, page 468.)

In the opinion of the Board, accepted demand bills on which the drawer is released from liability are not "bills of exchange" within the meaning of section 13 and must, therefore, be included in determining the limits on the amount of paper of any one borrower which a Federal reserve bank may rediscount for any member bank.

(Opinion of Counsel, Federal Reserve Bulletin, November, 1919, page 1055.)

See also "Rediscount of Promissory Notes," pages 97-103, above.

Evidence of  
"actually existing  
value"

Qualified  
acceptances

Accepted  
demand  
bills

**AGGREGATE AMOUNT REDISCOUNTABLE FOR  
ONE BANK**

See "Rediscount of Promissory Notes," pages 103-104, above.

**INDORSEMENT OF MEMBER BANKS**

See "Rediscount of Promissory Notes," page 104, above.

**REDISCOUNT FOR NONMEMBER BANKS**

See "Rediscount of Promissory Notes," pages 104-106, above.

## Rediscount of Six Months' Agricultural Paper

### DEFINITION

#### Regulations of Federal Reserve Board

Six months' agricultural paper, within the meaning of this regulation, is defined as a note, draft, bill of exchange, or trade acceptance drawn or issued for agricultural purposes, or based on live stock; that is, a note, draft, bill of exchange, or trade acceptance the proceeds of which have been used, or are to be used, for agricultural purposes, including the breeding, raising, fattening, or marketing of live stock, and which has a maturity at the time of discount of not more than six months, exclusive of days of grace.

Live stock  
paper  
included

(Regulations of Federal Reserve Board, Regulation A, Series of 1920, A, VI.)

### Opinions and Rulings

The term "live stock" is held to include not only beef cattle, but also horses and mules.

Live stock

(Ruling, Federal Reserve Bulletin, June, 1915, page 72.)

Notes made by mule and cattle dealers are mercantile rather than agricultural paper.

Notes of  
cattle dealers

(Ruling, Federal Reserve Bulletin, August, 1915, page 212.)

A note made by a dealer in agricultural implements is not agricultural paper.

Notes of  
implement dealers

(Ruling, Federal Reserve Bulletin, August, 1915, page 212.)

Paper covering sales by a manufacturer of agricultural implements to a dealer for resale by him to a farmer would have to be treated as commercial and not as agricultural paper.

Sales to  
implement dealers

(Ruling, Federal Reserve Bulletin, November, 1918, page 1118.)

Agricultural  
and com-  
mercial paper  
distinguished

The purchase and sale of any articles or commodities including agricultural products is a commercial rather than an agricultural transaction. The note of a farmer, however, given in payment for articles or commodities purchased may be considered agricultural paper, provided that the articles or commodities purchased are to be used by the farmer for agricultural purposes and are not in the nature of permanent or fixed investments.

(Ruling, Federal Reserve Bulletin, December, 1920, pages 1302, 1303.)

### ELIGIBLE AGRICULTURAL PAPER Statutory Provisions

Agricultural  
purposes

Authority of  
Federal  
Reserve Board

Limitations

Any Federal reserve bank may discount . . . . notes, drafts, and bills of exchange issued or drawn for agricultural . . . . purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act. Nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products . . . . from being eligible for such discount . . . . Notes, drafts, and bills drawn or issued for agricultural purposes or based on live stock and having a maturity not exceeding six months, exclusive of days of grace, may be discounted in an amount to be limited to a percentage of the assets of the Federal reserve bank, to be ascertained and fixed by the Federal Reserve Board.

(Federal Reserve Act, Section 13.)

### Regulations of Federal Reserve Board

To be eligible for rediscount, six months' agricultural paper, whether a note, draft, bill of exchange, or trade acceptance, must comply with the respective sections of this regulation\* which would apply to it if its maturity were ninety days or less.

(Regulations of Federal Reserve Board, Regulation A, Series of 1920, A, VI.)

Conditions of eligibility

### Opinions and Rulings

A farmer's six months' note for commercial fertilizer, discounted and indorsed by a member bank, is agricultural paper eligible for rediscount with the Federal reserve bank.

Notes for fertilizer

(Ruling, Federal Reserve Bulletin, June, 1915, page 75.)

The Act does not require the taking of chattel mortgages as security for loans based on agricultural operations. The statement of the member bank to this effect must ordinarily be accepted. The direct, primary purpose of the loan should be for the ordinary operations of agriculture. Words "based on" are not considered synonymous with "secured by." Agricultural paper need not be directly secured by agricultural products, but should be genuinely based upon transactions entered upon for agricultural operations. General banking prudence and knowledge should be applied.

Chattel mortgages unnecessary

(Ruling, Federal Reserve Bulletin, June, 1915, page 72.)

Notes signed by a farmer, the proceeds of which are used for the purchase of cows to be used as dairy cattle, are eligible for rediscount at the discretion of the Federal reserve bank notwithstanding the

Notes for dairy cattle

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\*For conditions of eligibility of promissory notes, see pages 77-94, above. For conditions of eligibility of drafts and trade acceptances, see pages 113-121, above.

fact that the cattle are not primarily purchased for "breeding, raising, fattening, and marketing of live stock."

(Ruling, Federal Reserve Bulletin, March, 1916, page 112.)

Cattle for  
breeding,  
grazing, or  
fattening

Loans on cattle for breeding, grazing, or fattening may be made under the classification of six months' agricultural paper and the paper may be rediscounted by a member bank at its Federal reserve bank.

(Ruling, Federal Reserve Bulletin, December, 1916, page 679.)

Use of  
mortgages

A loan made by a member bank in good faith to a farmer for the purpose of assisting him to produce a crop to fatten his cattle would be eligible for discount by a Federal reserve bank, whether secured by mortgage or not, but most of the farmers' notes which have been discounted with Federal reserve banks for member banks are secured by chattel mortgages.

(Ruling, Federal Reserve Bulletin, May, 1917, page 378.)

Farm  
tools and  
equipment

Farm tools, agricultural implements and machinery, or other farm operating equipment do not constitute permanent and fixed investments when they are of such character that they have to be replaced within a comparatively short time, so that it may be assumed that a certain amount of money would be spent annually and regularly for their replacement. Notes of farmers or consumers given for the purchase price of such equipment are discountable as notes drawn or issued for agricultural purposes.

(Ruling, Federal Reserve Bulletin, December, 1920, page 1302.)

Presentation of notes of farmers or consumers for the purchase price of farm tools or agricultural machinery by the dealer with his indorsement for rediscount does not change their classification as for agricultural purposes.

(Ruling, Federal Reserve Bulletin, February, 1916, page 67.)

Where tractors are used to supplement the work of horses or mules, or are used altogether instead of these animals, it is held that notes given by farmers for the purchase price of tractors, and maturing within six months, should be admitted to discount as agricultural paper.

(Ruling, Federal Reserve Bulletin, April, 1918, page 309.)

Farmers' notes, the proceeds of which are used for tilling farms or for draining land already in use as farm land, should be classified as agricultural paper and are eligible for rediscount.

(Ruling, Federal Reserve Bulletin, August, 1918, page 743.)

A note given for the purchase price of a commodity can be classed as agricultural paper eligible for rediscount when having a maturity in excess of ninety days, if the maker is to use the commodity for an agricultural purpose, regardless of whether the note is discounted by the maker or by the indorser.

(Opinion of Counsel, Federal Reserve Bulletin, April, 1918, page 312).

Where a farmer makes his note payable to the seller of a commodity, and actually uses the commodity for agricultural purposes, such a note may be treated as agricultural paper, whether discounted with the member bank by the farmer as the maker or by the seller as the indorser.

Presentation by dealer

Notes for farm tractors

Tilling and draining land

Discount by maker or indorser

Paper payable to seller of commodity

Paper  
payable  
to bank

Where the farmer makes his note payable to the member bank and uses the proceeds for an agricultural purpose, such a note may likewise be discounted by a Federal reserve bank as agricultural paper. If, however, in either of the foregoing cases the farmer does not use or intend to use the commodity purchased for an agricultural purpose, although it is capable of being so used, the note in question should be treated as commercial paper and not as agricultural paper.

(Ruling, Federal Reserve Bulletin, April, 1918, page 810.)

Paper of  
irrigation  
company

Where there is offered for rediscount as agricultural paper the note of an irrigation company which owns and operates an irrigation system and a rice farm, the Federal reserve bank must be satisfied that the proceeds of the particular note have been in fact used for an agricultural purpose in connection with the rice farm, as distinguished from a commercial purpose in connection with the delivery and sale of water to farmers through the irrigation system.

(Ruling, Federal Reserve Bulletin, September, 1920, page 949.)

Note for  
irrigation  
purposes

A farmer's note given to an irrigation company in payment for a supply of water which has been or is to be used for current agricultural purposes is a note which has been issued by the farmer for an agricultural purpose and may, therefore, be eligible for discount with a maturity not in excess of six months, provided, of course, it complies in other respects with the provisions of the law and the regulations of the Board.

(Ruling, Federal Reserve Bulletin, August, 1921, page 964.)

Drafts drawn by cotton growers, accepted by a cooperative marketing association organized for the purpose of marketing the cotton delivered by the growers, and discounted by the growers at their banks may be eligible for rediscount when it is shown that the proceeds of the accepted drafts have been or are to be used by the growers for agricultural purposes.

Acceptances  
of cooperative  
marketing  
associations

(Ruling, Federal Reserve Bulletin, November, 1920, page 1177; see also October, 1921, page 1200.)

The nature of the bill, the name of the acceptor, and the name of the drawer would probably indicate that a farmer was the purchaser, and an implement dealer, the seller of the goods. However, the purchasing member bank will have to satisfy itself in some satisfactory way that the bill is substantially of an agricultural character. A simple memorandum attached to the bill, stating that the bill was drawn in payment of agricultural implements, signed either by the acceptor or the drawer, would probably be considered sufficient evidence by the member bank and the Federal reserve bank.

Identification  
of agricultural  
paper

(Ruling, Federal Reserve Bulletin, February, 1916, pages 67, 68.)

### INELIGIBLE AGRICULTURAL PAPER

The bill or note of a packing company, the proceeds of which are used for the purchase of live stock which is slaughtered upon purchase, is not "based on live stock" within the meaning of section 13, and is, therefore, not eligible for rediscount if it has a maturity in excess of ninety days.

Notes or  
bills of  
packing  
company

(Opinion of Counsel, Federal Reserve Bulletin, August, 1917, page 616.)

Where the proceeds of a note made by a merchant are used to purchase millet seed to be later

Purchase  
for  
resale

**Note of irrigation company**  
retailed or sold, such a note can not be treated as one given for an agricultural purpose and can not be discounted by a Federal reserve bank if it has a maturity at time of discount of more than ninety days.

(Opinion of Counsel, Federal Reserve Bulletin, October, 1916, page 526.)

**Paper secured by chattel mortgage**  
A note of an irrigation company can not be classed as agricultural paper and can not be eligible for discount by Federal reserve banks if it has a maturity in excess of ninety days.

(Ruling, Federal Reserve Bulletin, August, 1921, page 964.)

**Permanent or fixed investments**  
A promissory note even though secured by collateral notes which in turn are secured by chattel mortgages on cattle would not be eligible for rediscount by a Federal reserve bank because it is not drawn for an agricultural, industrial or commercial purpose.

(Ruling, Federal Reserve Bulletin, September, 1917, page 691.)

**Purchase of silos**  
A note of a farmer discounted by him at his local bank to provide funds with which to purchase articles for agricultural uses is ineligible for rediscount if the articles are in the nature of permanent or fixed investments.

(Ruling, Federal Reserve Bulletin, December, 1920, page 1302.)

**Silos**  
Silos are considered to be permanent or fixed improvements, and it would require a forced construction of the Act to treat paper given for their purchase as eligible for rediscount as agricultural paper.

(Ruling, Federal Reserve Bulletin, October, 1918, page 971.)

The Board has ruled upon the basis of facts in a particular case that an electric system for furnishing light and power for an individual farm is in the nature of a permanent or fixed investment.

(Ruling, Federal Reserve Bulletin, December, 1920, page 1302.)

## AMOUNT OF PAPER REDISCOUNTABLE BY A FEDERAL RESERVE BANK

### Statutory Provisions

Notes, drafts, and bills drawn or issued for agricultural purposes or based on live stock, and having a maturity not exceeding six months, exclusive of days of grace, may be discounted in an amount to be limited to a percentage of the assets of the Federal reserve bank, to be ascertained and fixed by the Federal Reserve Board.

(Federal Reserve Act, Section 13.)

Discretion of Federal Reserve Board

### Opinions and Rulings

The law prescribes that in the aggregate the total amount of agricultural paper purchased by a Federal reserve bank should not exceed a fixed percentage of its capital stock, to be fixed from time to time for each Federal reserve bank by the Federal Reserve Board. The percentage fixed by the Board differs in the various districts. Whenever a district has applied, the maximum limit has been granted, which has been considered to be ninety-nine per cent. of the capital stock.

Limit of agricultural paper rediscountable by reserve bank

(Ruling, Federal Reserve Bulletin, February, 1916, page 68.)

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For other provisions governing the rediscoun of agricultural paper, see pages 97-106, 121-123, above.

## Rediscount of Bank Acceptances

### DEFINITION

#### Regulation of Federal Reserve Board

Banker's acceptance

A banker's acceptance within the meaning of this regulation is defined as a draft or bill of exchange, whether payable in the United States or abroad and whether payable in dollars or some other money, of which the acceptor is a bank or trust company, or a firm, person, company, or corporation engaged generally in the business of granting bankers' acceptance credits.

(Regulation A, Series of 1920, B.)

### Opinions and Rulings

Eligible acceptors

The question of determining the eligibility of an acceptor under the regulation is left to the discretion of Federal reserve banks themselves. It is, of course, understood that the board would not wish to see concerns regarded as eligible acceptors which are not in the habit of carrying on some acceptance business regularly and are not generally of such character and standing as to qualify their acceptance as a "banker's acceptance."

(Ruling, Federal Reserve Bulletin, November, 1915, page 362.)

Conditions of negotiability

A bill of exchange, in order to be negotiable, must be an unconditional order to pay, on demand or at a fixed or determinable future time, a certain sum of money to order or to bearer. If payment is dependent upon the happening of a certain contingency, the bill is conditional and nonnegotiable. If payment is confined to the proceeds of a particular fund and is not chargeable to the general credit of the drawer, the bill is conditional and nonnegotiable.

Conditional bill

A general acceptance of a conditional bill or a conditional acceptance of an unconditional bill makes the acceptance a conditional one and destroys its negotiability.

(Opinion of Counsel, Federal Reserve Bulletin, May, 1915, page 21.)

## ELIGIBLE BANK ACCEPTANCES

### Statutory Provisions

Any Federal reserve bank may discount acceptances of the kinds hereinafter described,\* which have a maturity at the time of discount of not more than three months' sight, exclusive of days of grace, and which are indorsed by at least one member bank.

(Federal Reserve Act, Section 18.)

### Regulations of Federal Reserve Board

A Federal reserve bank may discount any . . . . [banker's acceptance] having a maturity at time of discount of not more than three months, exclusive of days of grace, which has been drawn under a credit opened for the purpose of conducting or settling accounts resulting from a transaction or transactions involving any one of the following:

(1) The shipment of goods between the United States and any foreign country, or between the United States and any of its dependencies or insular possessions, or between foreign countries. While it is not necessary that shipping documents covering goods in the process of shipment be attached to drafts drawn for the purpose of financing the exportation or importation of goods, and while it is not essential, therefore, that each such draft cover

\* See Part I, "General Statutory Provisions," pages 9-10, above.

## Documents

specific goods actually in existence at the time of acceptance, nevertheless it is essential as a prerequisite to eligibility either (a) that shipping documents or a documentary export draft be attached at the time the draft is presented for acceptance, or (b) if the goods covered by the credit have not been actually shipped, that there be in existence a specific and bona fide contract providing for the exportation or importation of such goods at or within a specified and reasonable time and that the customer agree that the accepting bank will be furnished in due course with shipping documents covering such goods or with exchange arising out of the transaction being financed by the credit. A contract between principal and agent will not be considered a bona fide contract of the kind required above, nor is it enough that there be a contract providing merely that the proceeds of the acceptance will be used only to finance the purchase or shipment of goods to be exported or imported.

## Domestic shipments

(2) The shipment of goods within the United States, provided shipping documents conveying security title are attached at the time of acceptance, or

## Storage of staples

(3) The storage of readily marketable staples,\* provided that the bill is secured at the time of acceptance by a warehouse, terminal, or other similar receipt, conveying security title to such staples, issued by a party independent of the customer, and provided further that the acceptor remains secured

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\*A readily marketable staple within the meaning of these regulations may be defined as an article of commerce, agriculture, or industry of such uses as to make it the subject of constant dealings in ready markets with such frequent quotations of price as to make (a) the price easily and definitely ascertainable and (b) the staple itself easy to realize upon by sale at any time. [For specific rulings, see pages 43-45, above.]

throughout the life of the acceptance. In the event that the goods must be withdrawn from storage prior to the maturity of the acceptance or the retirement of the credit, a trust receipt or other similar document covering the goods may be substituted in lieu of the original document, provided that such substitution is conditioned upon a reasonably prompt liquidation of the credit. In order to insure compliance with this condition it should be required, when the original document is released, either (a) that the proceeds of the goods will be applied within a specified time toward a liquidation of the acceptance credit or (b) that a new document, similar to the original one, will be resubstituted within a specified time.

A Federal reserve bank may also rediscount any bill drawn by a bank or banker in a foreign country or dependency or insular possession of the United States for the purpose of furnishing dollar exchange, as provided in regulation C, provided that it has a maturity at the time of discount of not more than three months, exclusive of days of grace.

(Regulation A, Series of 1920, B.)

#### Opinions and Rulings

The term "shipping documents" as used in the regulation includes an order bill of lading or a straight bill of lading, whichever is issued by the carrier in the particular case, but does not include freight receipts or mere copies of original bills of lading. The purpose of the requirement that the accepting bank shall be furnished with shipping documents is not merely evidentiary, but is also to put the accepting bank in possession of the original documents, so that it may protect itself by retaining such documents until it is put in funds to meet the

Shipping documents to be furnished

Purpose of requirement

acceptance. It is realized that this protection is not always absolute and that the protection afforded by possession of a straight bill of lading is not so great as that afforded by possession of an order bill of lading. It is not the purpose of the Board, however, to prescribe the type of bill of lading to be issued in the particular case, but only to require the accepting bank to be furnished with the best security which has been issued by the carrier in the particular transaction.

The Board rules, therefore, that the customer must furnish the original bills of lading and that the requirement of the regulation will not be satisfied by the furnishing of freight receipts or non-negotiable copies of the bills of lading. This does not, however, mean that the bills of lading must necessarily be sent to the accepting bank. The Board has ruled in connection with domestic acceptances that documents are legally in the possession of the accepting bank when they are held by its correspondent, or by some other independent party, as its agent, and the principle of this ruling can be applied in dealing with the shipping documents to be furnished to banks accepting drafts drawn in foreign transactions.

(Ruling, Federal Reserve Bulletin, February, 1921, page 191.)

Custody of documents

Exchange in import transactions

Acceptances drawn to finance the purchase or production of goods under contract for export are eligible for rediscount or purchase only when the customer definitely agrees that the accepting bank will be furnished in due course with shipping documents covering such goods.

The furnishing of "exchange arising out of the transaction being financed by the credit" is in-

tended as an alternative to the furnishing of shipping documents only in import transactions.

(Ruling, Federal Reserve Bulletin, January, 1921, page 71.)

There is some doubt in the courts whether the mere reference to a particular consignment of goods makes the bill conditional, some courts stating that it is merely an indication of the fund out of which the drawee is to reimburse himself; other courts holding that it makes the bill conditional because limiting payment to the proceeds of the particular shipment referred to. There is no doubt, however, that a reference, in general terms, on the face of an accepted bill to the effect that it is based on the exportation or importation of goods would not make it conditional and nonnegotiable, and it would not, therefore, be ineligible for discount under the provisions of section 13 of the Federal Reserve Act.

Reference to  
fact bill is  
based on  
imports or  
exports

(Opinion of Counsel, Federal Reserve Bulletin, May, 1915, page 21.)

Federal reserve banks may, under the provisions of section 13, discount acceptances based on the importation or exportation of goods, provided they have a maturity at time of discount of not more than three months, and provided, further, that they are indorsed by at least one member bank. It is immaterial whether this member bank is located in the district of the Federal reserve bank which is making the discount or in any other district, the term "member bank" being broad enough to include member banks wherever located.

Acceptances  
indorsed by  
member bank of  
another district

(Opinion of Counsel, Federal Reserve Bulletin, June, 1915, page 98.)

The Board has ruled that a draft drawn by an American exporter covering cotton consigned to his European agent may be eligible for rediscoun

Shipment  
of goods  
on con-  
signment

when shipping documents covering goods actually shipped for export are attached at the time the draft is presented for acceptance, although the goods covered by the documents have not been sold but are merely shipped on consignment to the exporter's agent abroad.

(Ruling, Federal Reserve Bulletin, April, 1921, page 419.)

Based on  
shipment  
of cattle

The Board has ruled that a national bank may accept a draft drawn upon it if secured at the time of acceptance by a bill of lading covering a shipment of cattle to a cattle raiser who has purchased them with the intention of fattening and reselling them. The period covered by the acceptance, however, should not be in excess of the period of credit which is usual and reasonably necessary to finance transactions of this character. Such acceptances when discounted and indorsed by a member bank, other than the accepting bank, are eligible for rediscount with a Federal reserve bank, provided they have maturities at the time they are offered for rediscount not in excess of three months and comply in all other respects with the provisions of the Act and the regulations.

(Ruling, Federal Reserve Bulletin, July, 1921, page 815.)

Warehouse  
receipts of  
independent  
warehouses

In purchasing or discounting bankers' acceptances or other bills which are secured by warehouse receipts, etc., the Federal reserve banks should make sure that the receipt is issued by a warehouse which is independent of the borrower.

(Ruling, Federal Reserve Bulletin, January, 1917, page 30.)

Foreign  
warehouse  
receipts

A draft drawn abroad, payable in the United States in dollars and secured by a warehouse receipt covering readily marketable staples stored in a warehouse located in a foreign country, is eligible

for acceptance by a member bank, and after acceptance is eligible for rediscount by a Federal reserve bank.

(Opinion of Counsel, Federal Reserve Bulletin, August, 1919, page 740.)

A draft drawn by a cooperative marketing association against negotiable warehouse receipts covering nonperishable agricultural commodities to which the association has title and which are stored in independent warehouses is eligible for rediscount after acceptance, provided it complies in all respects with the regulations.

(Ruling, Federal Reserve Bulletin, August, 1921, page 968.)

Acceptances of an acceptance corporation ought to be dealt with exactly as would be the acceptances of a prime private banker. These acceptance corporations are in the same relation to the Federal Reserve System as the private bankers. They can not become members, but, inasmuch as they expect to give full information about their own financial standing and the nature of their acceptances, and as they exercise a most important function for the further development of our acceptance business and discount market, their operation ought to be encouraged in every respect.

(Ruling, Federal Reserve Bulletin, July, 1918, page 635.)

Although the Federal reserve banks legally may rediscount any draft which section 13 authorizes a member bank to accept, nevertheless such reserve banks are not required by law to rediscount every such acceptance tendered to them for that purpose, whether or not it is secured at the time it is presented for rediscount.

(Ruling, Federal Reserve Bulletin, March, 1919, page 253.)

Acceptances for  
cooperative  
associations

Paper of  
acceptance  
corporation

Option to  
rediscount

**Payment for acceptance at maturity**

The discount committee of the Federal Reserve Board has reported that, in its opinion, "Federal reserve banks should insist that acceptances when due should be paid by checks on the local Federal reserve bank, in order that they may be charged to the account of the acceptor on the day of maturity, or else that acceptances should be paid by checks through the clearings. If an arrangement on these lines can not be perfected, Federal reserve banks ought to be required to add one day to the actual number of days the acceptance has to run when bought, so as to make up for the loss of interest incurred in collecting in this manner."

This report has been agreed to by the Board, and your bank is requested, in buying acceptances, to charge discount for one additional day, except in cases where satisfactory arrangements are made to make actual cash payment at the Federal reserve bank on the day of maturity.

(Ruling, Federal Reserve Bulletin, June, 1918, page 521.)

For additional opinions and rulings bearing on this subject, see Part I, "Bank Acceptances," pages 11-19, 32-37, 43-51, 53-57, above.

## INELIGIBLE BANK ACCEPTANCES

### Opinions and Rulings

**Acceptances for dealers engaged in export and domestic sale**

Acceptances drawn to finance the purchase or production of goods under contract for export will no longer be eligible for rediscount or purchase if the customer is given the option to furnish warehouse receipts or similar documents covering goods not intended for export, and thus to change the nature of the acceptance.

(Ruling, Federal Reserve Bulletin, January, 1921, page 71.)

The acceptance of drafts secured by bills of lading for the primary purpose of providing the borrower with working capital during the period required to manufacture and resell the goods covered by the bills of lading is an abuse of the domestic acceptance privilege, and Federal reserve banks should decline to rediscount or purchase acceptances made for such purpose. Use of  
proceeds

(Ruling, Federal Reserve Bulletin, December, 1920, page 1301.)

The Board is of the opinion that a draft drawn Finance  
paper by a cotton factor, secured at the time of acceptance by a warehouse receipt covering cotton consigned to the cotton factor for the purpose of sale, where it appears that the proceeds are to be used by the factor not for a commercial purpose but rather for the purpose of lending to his customers, is not eligible for acceptance, and in consequence is not eligible for rediscount by a Federal reserve bank as an acceptance.

(Ruling, Federal Reserve Bulletin, February, 1920, page 162.)

National banks are not authorized to accept bills secured by chattel mortgages on cattle, and Federal reserve banks should consider as ineligible bills drawn against the security of such chattel mortgages, whether accepted by member or nonmember banks. Chattel  
mortgage  
security

(Ruling, Federal Reserve Bulletin, April, 1918, page 309.)

For additional opinions and rulings bearing on this subject, see Part I, "Bank Acceptances," pages 11-19, 32-37, 43-51, 53-57, above.

Evidence  
furnished  
Federal  
reserve  
bank

## EVIDENCE OF ELIGIBILITY

### Regulations of Federal Reserve Board

A Federal reserve bank must be satisfied, either by reference to the acceptance itself, or otherwise, that it is eligible for rediscount. The bill itself should be drawn so as to evidence the character of the underlying transactions, but if it is not so drawn, evidence of eligibility may consist of a stamp or certificate affixed by the acceptor in form satisfactory to the Federal reserve bank.\*

(Regulation A, Series of 1920, B.)

\* The following forms of the certificates referred to have been approved by the Federal Reserve Board and all Federal reserve banks:

Underlying Transaction	Form of Certificate
Domestic Shipments:	"At time of acceptance, this bill was accompanied by shipping documents evidencing the domestic shipment of (name of commodity) from (point of shipment) to (place of destination). (Name of Acceptor)"
Import and Export Transactions:	"This acceptance arises out of a transaction involving { importation } of (name of commodity) from (point of shipment) to (place of destination). (Name of Acceptor)"
Warehouse Secured Credit:	"This bill was secured at the time of acceptance by independent warehouse, terminal, or other similar receipt conveying security title to (name of readily marketable staple) stored in (country where stored) and the acceptor will remain secured throughout the life of the bill. (Name of Acceptor)"

(Circular No. 355, Federal Reserve Bank of New York.)

When drafts drawn for the purpose of furnishing dollar exchange are accepted, they are customarily stamped as follows: "This draft is accepted under authority of the Federal Reserve Board for the purpose of creating dollar exchange.  
(Name of Acceptor)"

**Opinions and Rulings**

The Federal reserve bank reserves the right to ask State member banks for evidence underlying the certification given to it, and the bank examiner may require evidence from the national bank. Member banks would, therefore, best protect themselves by stipulating for themselves the right at times to ask for substantiation of the assurances given by their customers.

(Ruling, Federal Reserve Bulletin, December, 1915, page 406.)

**MATURITY****Statutory Provisions**

Any Federal reserve bank may discount acceptances . . . which have a maturity at the time of discount of not more than three months' sight, exclusive of days of grace.

(Federal Reserve Act, Section 13.)

**Regulations of Federal Reserve Board**

Although a Federal reserve bank may legally re-discount an acceptance having a maturity at the time of discount of not more than three months, exclusive of days of grace, it may decline to rediscount any acceptance the maturity of which is in excess of the usual or customary period of credit required to finance the underlying transaction or which is in excess of that period reasonably necessary to finance such transactions. Since the purpose of permitting the acceptance of drafts secured by warehouse receipts or other such documents is to permit of the temporary holding of readily marketable staples in storage pending a reasonably prompt sale, shipment, or distribution, no such acceptance should have a maturity in excess of the time ordinarily necessary to effect a reasonably prompt sale,

Term  
of credit  
agreement

Renewals

Acceptances  
in excess  
of 10  
per cent.

shipment, or distribution into the process of manufacture or consumption.

While a national bank may properly enter into an agreement having more than six months to run by which it obligates itself to accept drafts of the kinds described in . . . . [section 13\*], each individual draft accepted under the terms of that agreement must, in order to be eligible, conform in all respects to the provisions of the law and these regulations. Inasmuch as each individual acceptance must itself conform to the terms of the law, no renewal draft, whether or not contracted for in advance, can be eligible if at the time of its acceptance the period required for the conclusion of the transaction out of which the original draft was drawn shall have elapsed. The question of the eligibility of renewal drafts, therefore, must necessarily depend upon the stage of the transaction at the time the renewal drafts are drawn.

(Regulation A, Series of 1920, B.)

### **AMOUNT OF PAPER OF ONE INTEREST REDIS-COUNTABLE FOR ONE MEMBER BANK**

#### **Regulations of the Federal Reserve Board**

In order to be eligible, acceptances for any one customer in excess of ten per cent. of the capital and surplus of the accepting bank must remain actually secured throughout the life of the acceptance. In the case of acceptances of member banks this security must consist of shipping documents, warehouse receipts or other such documents, or some other actual security growing out of the same transaction as the acceptance, such as documentary drafts, trade acceptances, terminal receipts, or trust receipts

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\* For Section 13, see pages 9-10, above.

which cover goods of such a character as to insure at all times a continuance of an effective and lawful lien in favor of the accepting bank. Other trust receipts are not secured within the meaning of this paragraph if they permit the customer to have access to or control over the goods.

(Regulation A, Series of 1920, B.)

See also "Rediscount of Promissory Notes," pages 97-103, above.

## INDORSEMENT

### Statutory Provisions

Any Federal reserve bank may discount acceptances . . . which are indorsed by at least one member bank.

Member bank  
indorsement

(Federal Reserve Act, Section 13.)

### Opinions and Rulings

If the acceptance is indorsed in blank it can of course change ownership from one holder to another without being indorsed by each subsequent holder, and the title would pass.

Indorsement  
in blank

The Board expresses the hope that we may soon reach the point when Federal reserve banks can make a definite rule not to buy bankers' acceptances except such as bear three responsible signatures, being those of the acceptor, the drawer, and the indorser.

(Ruling, Federal Reserve Bulletin, August, 1918, page 744.)

It appears that some national banks, in consideration of a fee or commission, are accustomed to indorse acceptances for the accommodation of their customers or bill brokers. Whether or not a national bank has authority to indorse an acceptance.

Accommodation  
indorsement

for accommodation is a question of law which in the last analysis must be determined by the courts. The Federal Reserve Board is of the opinion that a national bank has no authority to indorse an acceptance for accommodation, and that such act is ultra vires.

However, a national bank may purchase an acceptance and immediately resell it with its indorsement, since the power to indorse acceptances is incidental to the power to negotiate acceptances. There appears to be no authority of law which permits a national bank to lend its credit by indorsing an acceptance where the transaction does not involve an actual transfer of title to and from the national bank.

(Opinion of Counsel, Federal Reserve Bulletin, May, 1921, page 547.)

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For other provisions governing the rediscount of bank acceptances, see pages 103-106, above.

## PART III.

### Advances by Federal Reserve Banks

#### General Statutory Provisions

Any Federal reserve bank may make advances Maturity to its member banks on their promissory notes for a period not exceeding fifteen days at rates to be established by such Federal reserve banks, subject to the review and determination of the Federal Reserve Board, provided such promissory notes are secured by such notes, drafts, bills of exchange, or Security bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of this Act, or by the deposit or pledge Eligible paper of bonds or notes of the United States. United States obligations

(Federal Reserve Act, Section 13.)

The Federal reserve banks shall be authorized, subject to the maturity limitations of the Federal Reserve Act and to regulations of the Federal Reserve Board, to discount the direct obligations of member banks secured by . . . bonds of the [War Finance] Corporation . . . No discount or rediscount under this section shall be granted at a less interest charge than one per centum per annum above the prevailing rates for eligible commercial paper of corresponding maturity. War Finance Corporation bonds

(War Finance Corporation Act, Section 13.)

#### General Regulations of Federal Reserve Board

Any Federal reserve bank may make advances to its member banks on their promissory notes for a

**Security**

period not exceeding fifteen days, provided that they are secured by notes, drafts, bills of exchange, or bankers' acceptances which are eligible for rediscount or for purchase by Federal reserve banks, or by the deposit or pledge of bonds or notes of the United States, or bonds of the War Finance Corporation.

(Regulation A, Series of 1920, A, I.)

For conditions of eligibility of notes, drafts, and acceptances, see pages 77-87, 113-118, 126-131, 135-142, above, and 153-158, below.

**Security****Opinions and Rulings****Indorsement  
of  
collateral**

Eligible paper pledged as security for a promissory note of a member bank on which an advance is being made by a Federal reserve bank need not be indorsed by such member bank if such eligible paper is already in negotiable form.

(Opinion of Counsel, Federal Reserve Bulletin, December, 1916, page 685.)

**Preferential  
rate; collateral  
of war  
bonds**

The Federal Reserve Board may, under the terms of section 14 of the Federal Reserve Act, approve a preferential rate of discount upon member bank notes secured by certificates of indebtedness of the United States, by Liberty bonds, or by Victory notes. A Federal reserve bank, in the exercise of its discretion, may decline to make an advance upon such a note of a member bank unless the certificates of indebtedness, Liberty bonds, or Victory notes pledged as security are actually owned by the member bank and unless the Government deposit of such bank, if any, is secured by certificates of indebtedness, Liberty bonds, or Victory notes actually owned by it.

(Opinion of Counsel, Federal Reserve Bulletin, February, 1920, page 163.)

**Discretion of  
reserve  
bank**

Member banks in procuring advances from Federal reserve banks on promissory notes must secure such notes by paper eligible for rediscount or for purchase by Federal reserve banks or by bonds or notes of the United States. County warrants are not eligible as security.

(Opinion of Counsel, Federal Reserve Bulletin, November, 1916, page 609.)

Farm loan bonds are issued by Federal farm land banks incorporated under Federal law, and are not obligations of the United States, so that they are not eligible as collateral for promissory notes of member banks.

(Opinion of Counsel, Federal Reserve Bulletin, January, 1918, page 33.)

## Maturity

### Statutory Provisions

Any Federal reserve bank may make advances to ~~fifteen days~~ its member banks on their promissory notes for periods not exceeding fifteen days.

(Federal Reserve Act, Section 13.)

### Opinions and Rulings

If by reason of a State law paper falling due on Saturday or Sunday must be collected one or two days before its apparent maturity or one or two days thereafter, interest should be charged accordingly.

(Ruling, Federal Reserve Bulletin, February, 1918, page 108.)

A Federal reserve bank may properly renew the fifteen-day notes of its member banks if properly secured, provided that the Federal reserve bank does

County warrants ineligible

Farm loan bonds ineligible

Notes due on Sunday or legal holiday

Renewals permitted

not obligate itself in advance to make any such renewal.

(Opinion of Counsel, Federal Reserve Bulletin, October, 1917, page 765.)

**Renewals not encouraged**

While the Federal Reserve Board does not wish to prohibit the renewal of fifteen-day notes, it feels that renewals should be the exception rather than the rule.

(Ruling, Federal Reserve Bulletin, November, 1917, page 879.)

## PART IV.

### Open Market Transactions

#### General Statutory Provisions

Any Federal reserve bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the indorsement of a member bank.

Cable transfers, acceptances, and bills

Every Federal reserve bank shall have power . . . to purchase from member banks and to sell, with or without its indorsement, bills of exchange arising out of commercial transactions, as hereinbefore defined.

Commercial bills

(Federal Reserve Act, Section 14.)

Such drafts or bills [to provide dollar exchange] may be acquired by Federal reserve banks in such amounts and subject to such regulations, restrictions, and limitations as may be prescribed by the Federal Reserve Board.

Dollar exchange bills

(Federal Reserve Act, Section 13.)

#### General Regulations and Rulings

##### Regulations of Federal Reserve Board

The Federal Reserve Board, exercising its statutory right to regulate the purchase of bills of exchange and acceptances, has determined that a

Conditions governing eligibility

Prior  
acceptance

Six months'  
foreign  
trade  
bills

Goods under  
contract of  
sale

Purpose  
of new  
regulation

bill of exchange or acceptance, to be eligible for purchase by Federal reserve banks under this provision of section 14, must have been accepted by the drawee prior to such purchase unless it is either accompanied or secured by shipping documents or by warehouse, terminal, or other similar receipt conveying security title or bears a satisfactory banking indorsement, and must conform to the relative requirements of Regulation A,\* except that—

(a) A banker's acceptance growing out of a transaction involving the importation or exportation of goods may be purchased if it has a maturity not in excess of six months, exclusive of days of grace, provided that it conforms in other respects to the relative requirements of Regulation A,\* and

(b) A banker's acceptance growing out of a transaction involving the storage within the United States of goods actually under contract for sale and not yet delivered or paid for may be purchased, provided that the acceptor is secured by the pledge of such goods; and provided further that the acceptance conforms in other respects to the relative requirements of Regulation A.\*

(Regulation B, Series of 1921, II.)

### Announcements of Federal Reserve Board

The new regulation is issued primarily for the purpose of permitting Federal reserve banks until further notice to purchase in the open market bankers' acceptances with maturities not in excess of six months, which grow out of transactions involving the importation or exportation of goods.

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\* For requirements with respect to bills of exchange and trade acceptances, see pages 107-121, above; with respect to bank acceptances, see pages 134-146, above.

Two considerations have led the Board to take this action: (1) The desire to widen the acceptance market by meeting the wants of savings banks and similar purchasers of bankers' acceptances who are now deterred from investing in acceptances of longer than three months' maturity, because of the lack of authority of Federal reserve banks to purchase longer maturities up to six months; (2) to provide more ample facilities for financing import and export trade with countries where either normal conditions or present abnormal conditions indicate the desirability of rendering assistance by making acceptances of maturities not exceeding six months eligible for purchase by Federal reserve banks. While the Federal reserve banks would, under ordinary conditions, prefer to confine their investments to paper of short maturity, that is, not exceeding three months, it is believed that the present emergency in the foreign trade situation would be relieved by a more liberal practice. Vigilant care, however, should be exercised by Federal reserve banks in purchasing acceptances of long maturities, in order that the liquidity of the aggregate investment in acceptances held by them should not be affected. In amending its regulation in the manner described, the Board looks to the good banking judgment and discretion of the accepting banks and of the Federal reserve banks to avoid any untoward results. To avoid misunderstanding, the Board desires to add that the results of this widening of the investment powers of the Federal reserve banks will be followed closely, with a view to such modification of its rules or amendment of its regulations as future developments may indicate to be necessary.

Acceptance market

Foreign trade

Acceptances  
against  
goods  
stored

The Board has also taken this occasion to make another slight amendment to Regulation B so that its terms will more clearly indicate the Board's purpose in permitting Federal reserve banks to purchase in the open market bankers' acceptances growing out of the domestic storage of goods other than readily marketable staples.

(Announcement, Federal Reserve Bulletin, May, 1921, page 545.)

### Opinions and Rulings

Promissory  
notes  
excluded

The original bill for the establishment of Federal reserve banks permitted the purchase in the open market of "notes, drafts, and bills of exchange," but in the bill as finally enacted the words "notes and drafts" were stricken out in section 14, although they are retained in section 13. The Board has reached the conclusion, in which it is sustained by opinion of counsel, that Congress drew a distinction in sections 13 and 14 between the several forms of commercial paper, and that promissory notes, even though bearing an additional indorsement, must be regarded as excluded from open market purchases under section 14.

Eligible paper

There remain, then, as eligible for purchase under this section, "cable transfers" and "bills of exchange" of two kinds: (1) so-called foreign bills of exchange; and (2) domestic acceptances drawn by one party on another, as by a seller of goods upon the purchaser, such as have been classified by the Board as trade acceptances either accepted or not accepted at the time of purchase.

Discretion of  
reserve  
banks

The decision whether Federal reserve banks should engage in such open market operations rests entirely with them and not with the Federal Reserve Board.

Any Federal reserve bank may, under the provisions of section 14 of the Federal Reserve Act, purchase acceptances and bills of exchange of certain kinds and maturities in the open market; but promissory notes as distinguished from bills of exchange, whether one or more names, are not eligible for such purchase. Promissory notes

(Opinion of Counsel, Federal Reserve Bulletin, November, 1915, page 365.)

The purchase of commodity loans from member banks without their indorsement would not come within the provisions of the law unless there is two-name commodity paper or such paper can be created in connection with commodity loans. Commodity paper

(Ruling, Federal Reserve Bulletin, December, 1915, page 406.)

## Eligible Bills and Acceptances

### Opinions and Rulings

Gold bars may be properly considered as goods, and accordingly sixty-day bills when accepted by banks and bankers against such shipment would be eligible for purchase by Federal reserve banks as based upon or involving the exportation of goods. Bullion shipments

(Ruling, Federal Reserve Bulletin, January, 1917, page 29.)

Gold coin is "goods" within the meaning of section 13 of the Federal Reserve Act; and, therefore, a bill of exchange drawn to finance a shipment of gold coin from this country is eligible for purchase by a Federal reserve bank if otherwise in conformity with the provisions of the law and the regulations of the Federal Reserve Board. Coin shipments

(Ruling, Federal Reserve Bulletin, January, 1917, page 29.)

Goods  
consigned  
to foreign  
agents

The Board is of the opinion that acceptances drawn against commodities shipped to foreign countries, to be held on consignment by the shippers' agents until sales have been effected are technically eligible for purchase in the open market, provided that the goods are actually shipped for export and shipping documents covering such goods are attached to the draft at the time it is presented for acceptance, and provided that in other respects the drafts comply with the law and the Board's regulations governing open-market operations.

Although such acceptances are technically eligible for purchase, the Federal reserve bank, before purchasing the acceptances, should be reasonably sure that the goods will be sold before the maturity of such acceptances, for the use of acceptances is proper only where it is anticipated at the time the acceptances are drawn that they will be liquidated out of the proceeds derived from the sale of the goods under the acceptance.

(Ruling, Federal Reserve Bulletin, April, 1921, page 419.)

For additional rulings, see Part II, "Rediscounts with Federal Reserve Bank," pages 113-118 and 135-142, above.

## Ineligible Bills and Acceptances

### Opinions and Rulings

Acceptances  
not based  
on sales and  
not secured

Acceptances drawn by a manufacturer on and accepted by a trust company not a member of the Federal Reserve System, the proceeds of which are to be used for purchases of raw material and payment for labor where the goods had not been sold and no warehouse receipts or other instruments

could be furnished, are held not to be eligible for purchase by a Federal reserve bank.

(Ruling, Federal Reserve Bulletin, February, 1916, page 65.)

A banker's acceptance drawn for the purpose of purchasing goods secured by a bill of sale of stock in hand is not eligible for purchase by Federal reserve banks.

(Opinion of Counsel, Federal Reserve Bulletin, December, 1916, page 684.)

The fact that a land company has stamped a bill a trade acceptance and has signed such statement as "acceptor" does not in itself make it a trade acceptance. The bill was accepted by a bank and not by the land company and is therefore not eligible for purchase as a trade acceptance.

(Ruling, Federal Reserve Bulletin, March, 1916, page 112.)

An instrument in the form of a bill of exchange, drawn by an agent of a corporation upon the corporation itself, is not a bill of exchange such as is eligible for purchase in the open market by Federal reserve banks.

(Opinion of Counsel, Federal Reserve Bulletin, September, 1916, page 462.)

For additional rulings, see Part II, "Rediscounts with Federal Reserve Banks," pages 118-120 and 142-143, above.

### Requirement of Statements

#### Regulations of Federal Reserve Board

A bill of exchange, unless indorsed by a member bank, is not eligible for purchase until a satisfactory statement has been furnished of the financial condition of one or more of the parties thereto.

Acceptances  
secured by  
bill of sale

Stamp "Trade  
Acceptance"  
has no value

Draft  
drawn on  
corporation  
by agent

Bills of  
exchange

Bank  
acceptances

A banker's acceptance, unless accepted or indorsed by a member bank, is not eligible for purchase until the acceptor has furnished a satisfactory statement of its financial condition in form to be approved by the Federal reserve bank and has agreed in writing with a Federal reserve bank to inform it upon request concerning the transaction underlying the acceptance.

(Regulation B, Series of 1921, III.)

### **Maturity Statutory Provisions**

Any Federal reserve bank may . . . purchase and sell . . . cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount.

Every Federal reserve bank shall have power . . . to purchase from member banks and to sell . . . bills of exchange arising out of commercial transactions.

(Federal Reserve Act, Section 14.)

### **Regulations of Federal Reserve Board**

Maturity  
as for  
rediscounts

The Federal Reserve Board, exercising its statutory right to regulate the purchase of bills of exchange and acceptances, has determined that a bill of exchange or acceptance, to be eligible for purchase by Federal reserve banks . . . must conform to the relative requirements of Regulation A,\* except that—

Exception

A banker's acceptance growing out of a transaction involving the importation or exportation of

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\*See Part II, "Rediscounts with Federal Reserve Banks," pages 121 and 145-146, above.

goods may be purchased if it has a maturity not in excess of six months, exclusive of days of grace.

(Regulation B, Series of 1921, II.)

### Indorsement

#### Statutory Provisions

Any Federal reserve bank may . . . purchase and sell . . . cable transfers and bankers' acceptances and bills of exchange . . . with or without the indorsement of a member bank.

Every Federal reserve bank shall have power . . . to purchase from member banks and to sell . . . bills of exchange arising out of commercial transactions.

(Federal Reserve Act, Section 14.)

#### Opinions and Rulings

It appears that some national banks, in consideration of a fee or commission, are accustomed to indorse acceptances for the accommodation of their customers or bill brokers. Whether or not a national bank has authority to indorse an acceptance for accommodation is a question of law which in the last analysis must be determined by the courts. The Federal Reserve Board is of the opinion that a national bank has no authority to indorse an acceptance for accommodation, and that such act is *ultra vires*.

Accommodation  
indorsement

However, a national bank may purchase an acceptance and immediately resell it with its indorsement, since the power to indorse acceptances is incidental to the power to negotiate acceptances. There appears to be no authority of law which permits a national bank to lend its credit by indorsing

an acceptance where the transaction does not involve an actual transfer of title to and from the national bank.

(Opinion of Counsel, Federal Reserve Bulletin, May, 1921, page 547.)

Purchase  
from  
acceptor

A Federal reserve bank technically has authority to purchase from the drawer, or even from the accepting bank, a banker's acceptance which bears no indorsement other than that of the accepting bank.

The normal and desirable practice, however, is for the drawer to discount acceptances with some bank other than the accepting bank, rather than for the accepting bank to discount the acceptances. In view, however, of the fact that the acceptance business is comparatively new in this country, and in view of the consequent lack of an adequate open market for bankers' acceptances in some districts, it has seemed best for some of the Federal reserve banks to purchase acceptances direct from the accepting banks, in the hope that the proper use of, and an active market for, bankers' acceptances may thereby be encouraged.

Use of  
commercial  
paper rate

It is, nevertheless, apparent that the indorsement of the accepting bank adds no strength to the instrument, since the accepting bank is already liable, primarily, as acceptor, and the Federal Reserve Board in February, 1920, instructed Federal reserve banks that all purchases direct from the accepting bank of bankers' acceptances bearing no member bank indorsement other than that of the accepting bank should be made at the prevailing rate for commercial paper rather than at the preferential rate applicable to bankers' acceptances as such.

The ten per cent. limitation on the discount of paper of any one borrower for any member bank does not apply to open market purchases. In view of the fact that an acceptance indorsed only by the accepting bank is supported by the credit of only two parties, and in this respect is like a customer's note indorsed by the bank, the Federal Reserve Board feels that a Federal reserve bank is justified in limiting its open-market purchases of bankers' acceptances of this character, so that it will at no time hold under rediscount or purchase from one member bank an aggregate amount in excess of ten per cent. of the member bank's capital and surplus of (1) notes, drafts, and bills bearing the signature or indorsement of any one borrower, and (2) bankers' acceptances made by the member bank for the same borrower, but bearing no indorsement other than that of the accepting bank. The Board has, however, issued no ruling upon this point, and for the time being at least is willing to leave the matter to the sound banking discretion of the officers of the Federal reserve banks.

Discretion of  
reserve banks  
to apply  
10 per cent.  
limit

(Ruling, Federal Reserve Bulletin, June, 1921, page 699.)



**APPENDIX:**  
**Acceptance Powers of International Financial Corporations**

**ACCEPTANCES OF FEDERAL CORPORATIONS**

**Statutory Provisions**

Each corporation so organized [for the purpose of engaging in international or foreign banking or other international or foreign financial operations, or in banking or other financial operations in a dependency or insular possession of the United States] shall have power, under such rules and regulations as the Federal Reserve Board may prescribe . . . to accept bills or drafts drawn upon Acceptances it subject to such limitations and restrictions as the Federal Reserve Board may impose; to issue letters of credit; . . . and generally to exercise such powers as are incidental to the powers conferred by this Act or as may be usual, in the determination of the Federal Reserve Board, in connection with the transaction of the business of banking or other financial operations in the countries, colonies, dependencies, or possessions in which it shall transact business and not inconsistent with the powers specifically granted herein. Nothing contained in this section shall be construed to prohibit the Federal Reserve Board, under its power to prescribe rules and regulations, from limiting the aggregate amount of liabilities of any or all classes incurred by the corporation and outstanding at any one time. Other powers

(Federal Reserve Act, Section 25 (a).)

### Regulations of Federal Reserve Board

#### Kinds

Any Corporation may accept (1) drafts and bills of exchange drawn upon it which grow out of transactions involving the importation or exportation of goods, and (2) drafts and bills of exchange which are drawn by banks or bankers located in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange as required by the usages of trade in such countries, dependencies, and possessions, provided, however, that, except with the approval of the Federal Reserve Board and subject to such limitations as it may prescribe, no Corporation shall exercise its power to accept drafts or bills of exchange if at the time such drafts or bills are presented for acceptance it has outstanding any debentures, bonds, notes, or other such obligations issued by it.

#### Maturity

Except with the approval of the Federal Reserve Board, no Corporation shall accept any draft or bill of exchange which grows out of a transaction involving the importation or exportation of goods with a maturity in excess of six months, or shall accept any draft or bill of exchange drawn for the purpose of furnishing dollar exchange with a maturity in excess of three months.

#### Limitations

(1) Individual drawers: No acceptances shall be made for the account of any one drawer in an amount aggregating at any time in excess of ten per cent. of the subscribed capital and surplus of the Corporation, unless the transaction be fully secured or represents an exportation or importation of commodities and is guaranteed by a bank or banker of undoubted solvency. (2) Aggregates: Whenever the aggregate of acceptances outstand-

ing at any time (a) exceeds the amount of the subscribed capital and surplus, fifty per cent. of all the acceptances in excess of the amount shall be fully secured; or (b) exceeds twice the amount of the subscribed capital and surplus, all the acceptances outstanding in excess of such amount shall be fully secured. (The Corporation shall elect whichever requirement (a) or (b) calls for the smaller amount of secured acceptances.) In no event shall any Corporation have outstanding at any one time acceptances drawn for the purpose of furnishing dollar exchange in an amount aggregating more than fifty per cent. of its subscribed capital and surplus.

Against all acceptances outstanding which mature in thirty days or less a reserve of at least fifteen per cent. shall be maintained, and against all acceptances outstanding which mature in more than thirty days a reserve of at least three per cent. shall be maintained. Reserves against acceptances must be in liquid assets of any or all of the following kinds: (1) cash; (2) balances with other banks; (3) bankers' acceptances; and (4) such securities as the Federal Reserve Board may from time to time permit.

Reserves

(Regulation K, Series of 1920, XIII.)

The total liabilities to a Corporation of any person, company, firm, or corporation for money borrowed, including in the liabilities of a company or firm the liabilities of the several members thereof, shall at no time exceed ten per cent. of the amount of its subscribed capital and surplus, except with the approval of the Federal Reserve Board: *Provided, however,* That the discount of bills of exchange drawn in good faith against actually existing values and the discount of commercial or

Liabilities  
of one  
borrower

business paper actually owned by the person negotiating the same shall not be considered as money borrowed within the meaning of this paragraph. The liability of a customer on account of an acceptance made by the Corporation for his account is not a liability for money borrowed within the meaning of this paragraph unless and until he fails to place the Corporation in funds to cover the payment of the acceptance at maturity or unless the Corporation itself holds the acceptance.

Aggregate liabilities

The aggregate of the Corporation's liabilities outstanding on account of acceptances, average domestic and foreign deposits, debentures, bonds, notes, guaranties, indorsements, and other such obligations shall not exceed at any one time ten times the amount of the Corporation's subscribed capital and surplus except with the approval of the Federal Reserve Board. In determining the amount of the liabilities within the meaning of this paragraph, indorsements of bills of exchange having not more than six months to run, drawn and accepted by others than the Corporation, shall not be included.

(Regulation K, Series of 1920, XV.)

## ACCEPTANCES OF STATE CORPORATIONS

### Statutory Provisions

Regulation  
of business

Before any national bank shall be permitted to purchase stock in any such corporation [chartered or incorporated under the laws of any state and principally engaged in international or foreign banking, or banking in a dependency or insular possession of the United States] the said corporation shall enter into an agreement or undertaking with the Federal Reserve Board to restrict its operations or conduct its business in such manner or

under such limitations and restrictions as the said board may prescribe for the place or places wherein such business is to be conducted.

(Federal Reserve Act, Section 25.)

### Regulations of Federal Reserve Board

The Board has concluded that you should be permitted to accept drafts and bills of exchange upon the same terms and subject to the same conditions, limitations and restrictions as are prescribed in Paragraph XIII of the Board's Regulation K, Series of 1920, with reference to the exercise of the acceptance powers of foreign banking corporations organized under the terms of Section 25(a) of the Federal Reserve Act.\*

Conditions as  
to acceptance  
business

(Form of agreement of foreign banking corporation as a condition precedent to the purchase of their stock by national banks, B. 1, effective February 23, 1921.)

### Opinions and Rulings

Acceptances of state foreign banking corporations which have agreed with the Federal Reserve Board to limit acceptances for account of any one drawer to ten per cent. of the accepting bank's capital and surplus, unless the transaction be fully secured, are not subject to the ten per cent. limitation where the acceptor is secured by the acceptance of the foreign buyer after the release of the documents.

Exemption  
from  
10 per cent.  
limit

(Ruling, Federal Reserve Bulletin, October, 1920, page 1065.)

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\* See above, page 165.



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# National Bank of Commerce in New York

ESTABLISHED 1839

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